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IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

* * * * *

vol 3288

TEMPLETON PATENTS, LTD.,	)	
Plaintiff-Appellant,	)	
v.	)	No. 18900
J. R. SIMPLOT COMPANY,	)	
Defendant-Appellee.	)	

See Vol. 3287

APPELLEE'S REPLY BRIEF IN NO. 18900

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FOR THE NINTH CIRCUIT

* * * * *

TEMPLETON PATENTS, LTD.,)
)
Plaintiff-Appellant,)
)
v.) No. 18900
)
J. R. SIMPLOT COMPANY,)
)
Defendant-Appellee.)

* * * * *

BRIEF FOR APPELLEE

* * * * *

I. INTRODUCTION

A. THE PLEADINGS.

This action, Civil No. 3574 in the District Court and here No. 18900, was filed by the plaintiff* in the language of the complaint, "for equitable relief by way of an accounting to recover the proceeds of an unjust enrichment and for breach of contract". Defendant filed its answer September 9, 1960, raising a number of affirmative defenses (R 11 - Answer) (R 30 - Pre-Trial Order), including laches, limitations, statute of fraud, and failure to join indispensable parties. Upon the issues thus framed, trial was commenced before Hon. Fred M. Taylor, District Judge, January 8, 1962, and concluded January 30, 1962.

---

*For convenience, appellant will be designated as plaintiff and appellee as defendant throughout this brief.

Findings of Fact and Conclusions of Law (R 42) and Final Judgment (R 52) were signed and entered by the court May 24, 1963, dismissing the complaint of the plaintiff, with prejudice, and with costs to this defendant.

Approximately one year prior to the filing of the complaint in this case, plaintiff filed an action for patent infringement against the defendant February 24, 1959, Civil No. 3514 in the District Court and here No. 18899, the District Court likewise by its final judgment therein dismissed the action for infringement filed by the plaintiff. The cases upon stipulation and order were consolidated for trial.

B. JURISDICTION.

Defendant concedes that the District Court had jurisdiction by virtue of diversity and amount in controversy under 28 U. S. C. A. § 1332(a)(2), and that final judgment having been rendered herein this court has jurisdiction over the appeal by virtue of 28 U. S. C. A. §§ 129 1292(a)(4).

II. STATEMENT OF THE CASE

Counsel frankly admit being taken by surprise in these appeals -- for the first time in the history of the litigation, plaintiff's main thrust is not directed to the infringement suit, which consumed nine-tenths of the total trial time and most of its briefing before and after trial, but instead is pointed to the alleged breach of contract action. Perhaps this new emphasis, coming at such a late date and so unexpec edly, is an admission that its infringement action is groundless.

Certainly it seems a confession of weakness.

Plaintiff for its Statement of the Case sets forth in full the Memorandum Opinion of Judge Taylor -- there being in its view "no better existing statement of the essential facts". It then, however, intersperses its lengthy argument (66 pages) with additional evidence from the case, which it argues as supporting facts.

Plaintiff should be aware that Judge Taylor's Opinion must give way, in case of doubt, to his Findings of Fact.

Plaintiff minimizes these Findings as being adopted two and a half months after the Opinion "from a draft by defendant". Surely counsel knows that any drafts were submitted at the specific request of the trial judge and are <u>not a part of the record on appeal</u>. This calculated departure from the record of the case, as will develop later, is not the last example we will find in plaintiff's brief.

Under the circumstances, we therefore will rely in the main for our statement of the case upon the explicit Findings of Fact of Judge Taylor, which constitute his considered and final determination of the essential facts in this suit. His Findings of Fact, I through XII, inclusive, are set forth as an Appendix to this brief.

The rule is clear that where there is any conflict between the Opinion and the Findings of Fact or any qualification of the Opinion by the Findings, the latter will control. This court has so ruled on at least two occasions:

<u>W. J. Ohlinger v. United States of America</u>, 9 Cir., 219 F.2d

310 (1955), at page 311:

> "* * * We do not agree with this assertion. Assuming that such a construction could be placed upon statements referred to, the trial court's memorandum of opinion may not be used to supplement the findings in this manner. Rule 52 of the Federal Rules of Civil Procedure, 28 U.S.C.A., provides: 'If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein.' Under the circumstances referred to in the rule, it is not necessary to file formal findings of fact and conclusions of law, but when the trial court does make formal findings, they alone serve as the court's findings of fact. In the words of the Supreme Court: 'We are not at liberty to refer to the opinion for the purposes of eking out, controlling, or modifying the scope of the findings'." (Emphasis ours.)

Platino v. Mills, 9 Cir., 236 F.2d 32 (1956), where this court stated, at page 35:

> "* * * The finding is in conflict with the trial court's opinion. This, it must not have intended. But in a direct conflict between the formal findings and the findings of an opinion, the formal findings must govern."

See also: Osaka Shosen Kaisha, Ltd. v. Angelos, Leitch & Co., Ltd., 4 Cir., 301 F.2d 59 (1962).

III. ARGUMENT

A. THIS COURT SHOULD ACCEPT THE FINDINGS OF THE TRIAL COURT UNLESS "CLEARLY ERRONEOUS".

While the trial court found because of the substantial conflict in the testimony concerning the dealings between the parties and the extended lapse of time until trial the writings between them constituted "the most credible evidence", nowhere does he say, as contended by plaintiff, that

he did not also give consideration to the testimony and the demeanor of the numerous witnesses.

Plaintiff relies on Lundgren v. Freeman, 9 Cir., 307 F. 2d 104 (1962), in urging this court to completely disregard Judge Taylor's Findings and to substitute in lieu thereof its view and interpretation of the facts. The court in Lundgren reviewed the decision of the United States Supreme Court which set forth the "Frank" view, allowing appellate courts to substitute its judgment on documentary evidence, as opposed to the "Clark" view, which applied the "clearly erroneous" rule to findings likewise predicated on documents or writings. In addition to the statement set forth by plaintiff from this case, we find at page 114:

> "Nothing in the history of review of equity cases or of law cases tried without a jury suggests that the appellate court ever decides issues of fact in the first instance, even where it considers itself as fully qualified as the trial judge to do so. Rule 52(a) should be construed to encourage appeals that are based on a conviction that the trial court's decision has been unjust; it should not be construed to encourage appeals that are based on the hope that the appellate court will second-guess the trial court. * * * Rule 52(a) explicitly clearly applies where the trial court has not had an opportunity to judge of the credibility of witnesses.
>
> "Further, one of the purposes of findings of fact is to give the appellate court a clear understanding of the basis of the trial court's decision. * * * There would be no real purpose for such a finding in the principal case, if the appellate court could hold a trial de novo."

Further, this court will not retry the lawsuit or the issues of fact. Irish v. United States, 9 Cir., 225 F. 2d 3 (1955). The findings are presumptively correct, the burden of showing compelling reasons to overturn them being on the appellant. Watson v. Button, 9 Cir.,

235 F. 2d 235 (1956). As stated in Horton v. U. S. Steel Corp., 5 Cir., 286 F. 2d 710 (1961) at page 713:

> "On this the District Court heard much testimony and made precise fact findings which come here well armed with the buckler and shield of F. R. Civ. P. 52(a), 28 U. S. C. A. * * *."

B. THE MARCH, 1949, MEETING AND TEMPLETON'S SUBSEQUENT CORRESPONDENCE.

1. A discussion of the March, 1949, meeting in Boise is important because it was at that time and place the "enforceable business understanding" contended for by plaintiff was conceived. However, we prefer to put plaintiff's interpretation of and conclusions about this meeting up against the record.

Simplot had on several occasions before met Templeton. Templeton was in the United States to exploit his patent position and to convince Simplot he should be licensed -- he, not Simplot, was the aggressor. Templeton then, and subsequently, held to the offer of an exclusive license. Templeton was extending no exclusive favors to Simplot out of friendship, but was dealing with all comers at the same time: A Maine operation, as early as 1948 (PX 8, III-34, 35); the U. S. Department of Agriculture in 1949 (T 736, 737); Basic Vegetable, Inc. in California in 1949 (PX 8, III-72).

Present at the March, 1949, meeting were the two principals, Templeton and Simplot, and also Robert Troxell, at that time the Executive Vice-President and General Manager of defendant, formerly its General Counsel. At the time of trial Troxell had no connection with

defendant and was engaged in the practice of law. Templeton was aware that Mr. Troxell was also defendant's attorney (T 892).

Simplot was interested in Templeton's proposition if the patents were what he claimed, but before any agreement would be made the proposal would be referred to his attorneys (T 1385, 1386). The discussion of terms was general, only, and not definite (T 1386).

In substance, Troxell testified: That Templeton came to Boise in 1949, representing plaintiff's predecessor in interest, as the owner of two issued patents and one patent applied for, under which he would give defendant an exclusive U. S. license (T 1309, 1310) (T 901, 905, 922, 923); Templeton said though Bunimovitch owned 75% of the Faitelowitz patent, he nevertheless could grant an exclusive license (T 1311); Templeton made no disclosure of the title infirmities to the Faitelowitz patent to either Simplot or Troxell, the same coming to Troxell's attention only after receiving Beale's opinion; Troxell advised Templeton after the latter made his licensing proposal that prior to "contract discussion, or any negotiations" the matter had to be referred to defendant's patent counsel for patent search as to validity, scope and title; that all discussion at the meeting was conditioned upon "real, detailed contract negotiation" and "detailed discussion of terms" and only after advice of patent counsel (T 1311); Templeton at the conclusion stated if he had time in San Francisco he would prepare a memorandum of the items which he felt should be in an agreement; Templeton felt such memorandum would be beneficial for "future consideration of the matter"

(T 1314).

In this connection, plaintiff makes the absurd comment that had Simplot not intended to make a final, binding contract in March, 1949, he would have at an earlier meeting in 1949 with Templeton in Washington D. C., mentioned to Templeton the qualification of advice from his attorneys. There is nothing in the record that prior to the meeting in Boise Templeton and Simplot had other than general discussions showing mutual interest in a licensing arrangement.

It is most difficult to consider seriously plaintiff's argument that a prospective licensee, based only on representations of the licensor as to validity, scope and title of his patents, would undertake a vast, costly contract and program and not have his personal counsel, as well as his patent counsel, at his elbow at every step of the way.

As it subsequently developed, this is the exact procedure defendant followed; and in view of Templeton's inability to perform as he had represented in March of 1949, defendant's reliance on its counsel is all the more reasonable, and certainly justified.

2. Plaintiff criticizes Simplot for his paucity of writings and implies some dark purpose in this connection. Would it be proper to suggest to plaintiff that the telephone has been introduced for some time and by now is a recognized medium for the conduct of business? In any event, Templeton by his blizzard of correspondence has conclusively established that the parties to this suit neither at the March, 1949, meeting or at any time subsequent thereto, ever reached that meeting

of minds, so essential to a binding, enforceable contractual arrangement. To winnow a few statements from Templeton's verbiage, demonstrating his awareness that any agreement was conditional and the parties were in the negotiation stage only, we refer to the following:

> (a) Letter to Simplot, March 8, 1949: "Contents of these documents represent my advice and embody my experience. It is all open to discussion and amendment to suit special local conditions which are not within my experience but are within yours." (PX 8, III-42)

> (b) Letter to Simplot, March 31, 1949: "I was sorry to have to return without hearing further from you, but no doubt your Legal Counsellor will be writing to mine, from whom he will have heard in the last few days.
>
> "After our telephone conversation I told Dean Edmonds to proceed with your Legal Advisor upon the basis that you and I had agreed in principle, and I asked him to submit a draft incorporating the points in my draft, subject to any legal aspects he wished to raise, and similarly to offer your Adviser the same courtesy - that is to say to provide a document as a draft and not as the finished article." (PX 8, III-72)

> (c) Letter to Troxell, April 11, 1949: "The questions you raise are all of the kind which Mr. Simplot and I agreed to leave to be thrashed out between our respective legal representatives and are no doubt very proper ones to be raised from your side. * * *.
>
> "I think the observation of Beale and Jones in regard to the form of Agreement is surely somewhat premature until you have heard the comments of Mr. Dean Edmonds. I would agree, of course, that it is inherent in the understanding between Mr. Simplot and myself that if the legal enquiries showed it to be necessary in his interests or ours the form of Agreement should be modified, then that would be done." (PX 8, III-80)

> (d) Letter to Simplot, April 13, 1949: "I have received with some disappointment the information contained in Mr. Troxell's letter to Mr. Dean Edmonds, based on advice you have received from Beal and Jones, Patent Attorneys.

"I do not know how much information Mr. Troxell gave to Beale and Jones before seeking their advice, which however reads to me as if it were given by Beale and Jones under the disadvantage of their failing to apprehend what is the invention. * * * .

"I may add that in conversation with Mr. Troxell, I think I did suggest, in response to his comment, that he would want Patent Agent's advice, that he should put your Patent Attorney directly in touch with ours. I think if this had been done the present position - which as far as I can see is based on misunderstanding - would not have arisen. * * *.

"* * * The understanding between you and me was agreed as being subject to the proviso that our legal advisers should be satisfied, and I am not raising any objection to the process necessary for their satisfaction * * *." (PX 8, III-83, 84)

(e) Letter to Jones, Vice-President, Defendant, May 4, 1949: " I have written various letters to Mr. Jack Simplot at Boise. I appreciate he is very busy and may be, as legal matters are involved anyway, he is to take advice and listen to the lawyers." (PX 8, III-91)

(f) Letter to Jones, May 12, 1949: "I shall be glad of your advice. When I saw Mr. Simplot in Idaho in March we reached an agreement subject to vetting and tidying up of the Lawyers. Your Lawyer has now raised certain points in answer to which I have suggested the simple course of his getting in touch with our Lawyer, because we think he is on the wrong track, and the quickest and easiest way back is by means of a straight forward discussion. I have no answer and do not know what is happening." (PX 8, III-94)

(g) Letter to Jones, May 30, 1949: "I do not have any doubt that Mr. Edmonds will be able to satisfy Beale and Jones that the legal position is as I have represented it to be to Mr. Simplot and others in your organisation * * *." (PX 8, III-101)

(h) Letter to Edmonds, copy to Troxell, June 24, 1949: "It is evident from your letter of the 10th June that Mr. Beale does not take very kindly to the Simplott/Templeton idea of a commercial agreement and his criticisms appear to go well outside the validity and/or strength of the patents.

"Insofar that I am implicated with Mr. Simplott under Mr. Beale's view, I can say it is not the first time in my life that after making a commercial agreement I have been criticized by an Attorney * * *." (PX 8, III-113)

(i) Letter to Beale, August 10, 1949: "Meanwhile perhaps I should say this. I understand concerning the agreement reached between Mr. Simplott and myself in March last - subject to the advice of our respective attorneys - that your advice to Mr. Simplott stands against his proceeding with the agreement for various reasons which you have argued at length. * * *.

"I believe Mr. Simplott wishes to proceed with the agreement we both made in good faith as I do also but statements as serious as those you have apparently made require that both he and I must pause to examine them." (PX 8, III-123)

(j) Letter to Simplot, October 12, 1949: "As I left Boise I understood we had reached agreement to which I have been loyal ever since. Certainly it was subject to your Attorney at Boise taking the advice on your behalf of Patent Attorneys and, as I thought, discussing the matter with my Patent Attorneys, but I assumed and I thought you assumed that unless some good reason could be shown to the contrary you and I had made a contract.

"* * * your Patent Agents instead of, as I thought, co-operating with mine to complete an agreement in the best interests of your Company and my Company had joined quite extensive endeavours to the entirely different object of putting forward a number of contentious arguments indicating why you should not proceed with the agreement. * * *.

"The time perhaps has now come for me to put to you the direct question. I have considered myself bound to this agreement and still do, but if you wish to call it off it is not right for you to keep me bound and I must be similarly free and I am entitled to the consideration of a definite answer from you. I wish to make it quite clear there is no attempt on my side to hold you to a bargain if you do not want to go on, but just say so. * * *." (PX 8, III-134-136)

(k) Letter to Simplot, February 23, 1950: "I explained to you on this last trip that I felt we ought

either to proceed with such an agreement or abandon it. * * *.

"I think you ought now to make up your mind either - * * *.

"(b) to say that you do not wish to proceed, in which event I think the best thing to do is for the both of us to agree to terminate our endeavour based upon setting up the relationship between us which I have described herebefore and in that case, as I said in New York, I think you ought to make some contribution towards the expenses I have been put to, much of them, as in the case of visits to Washington, at your direct request.

"Whilst I should regret this ending to a negotiation which has been over-long already I may add, in order to show you that I keep an open and I hope a fair mind in the matter, that I should be willing, if it would help you, to offer you a non-exclusive license * * *." (PX 8, III-171-174)

(l) Letter to Simplot, April 17, 1950: "I wish to lose no further time in the U. S. A. market and if you do not wish to go on upon our original understanding, I must open with one or 2 others whose interest in the past 18 months I have declined.

"As stated in my last letter I am quite prepared, if this is the position I have to face, to offer you a limited, non-exclusive licence for the patents which I represent for part or possibly the whole of the state of Idaho." (PX 8, III-175)

(m) Letter to Simplot, July 24, 1950: "I advise you of these matters in order that on my side no omission in obligation or courtesy shall occur into our long period of negotiation recently terminated, as a result of your wish and my objection to change our original understanding in a very material particular." (PX 8, III-176, 177)

(n) Letter to Simplot, August 30, 1950: "* * * I realise that in the course of recent rather protracted negotiation you were an exceedingly busy man with very many matters to consider.

"* * * As I understood the matter this was to be a deal subject to your legal adviser checking on the Patents. * * *.

"After some considerable delay we received from

Mr. Troxell a letter indicating that a firm of Patent Attorneys at Washington had written a letter in terms which we found is difficult to understand but which appeared to criticise the Patents as being not basic patents, whatever that might mean. * * *.

"In the intervening months I wrote you on more than one occasion and received no reply; on my last visit to U. S. A. during June and July I reluctantly came to the decision communicated to you in a recent letter and thereafterwards appointed Mr. William Scott as our Company's representative in relation to these processes." (PX 8, III-182-184)

(o) Letter to Simplot, June 13, 1956: "You will remember your Attorney, Ed. Beale, to whom at one stage you referred me, thought this Patent was the fundamental one and that our Volpertas and Rivoche Patents were not so strong.

"I did not agree with Beale, but to-day we have both Faitelowitz and Rivoche. * * *.

"It remains true that I did visit Boise and work with your colleagues, demonstrating the processes, and this was doubtless of some assistance." (PX 8, III-222)

C. THE UNSUCCESSFUL ATTEMPTS TO "MEMORIALIZE" THE TENTATIVE, INDEFINITE AND INFORMAL UNDERSTANDING.

1. Templeton's Heads of Agreement (PX 8, III-43-46) was the first of proposed forms of agreement exchanged. Although not signed by plaintiff, it requested execution by defendant. This, of course, was not done, the "Heads" obviously only representing Templeton's basic proposal to defendant. The "Heads" recited plaintiff as the exclusive licensee, assignee and owner of the three patents. Subject to minimum payments and tonnages, the license allegedly was exclusive to defendant, absent its written consent otherwise. For some reason, Templeton expected the "Heads" to be signed, binding the parties, although he knew

plaintiff would insist on proper legal advice and recommendation. (PX 8, III-80, 84)

2. The Edmonds draft was sent Troxell March 28, 1949, and allegedly was based on the "Heads" and additional information from Templeton. A deviation from the "Heads" permitted plaintiff to license R. T. French Co., without limitation. It referred to plaintiff as the owner of only "licensing rights" to Faitelowitz. It expanded the three and one-half pages of the "Heads" to eleven pages. Troxell had received Beale's opinion prior to receipt of the Edmonds draft.

Troxell wrote Edmonds April 6, 1949, (PX 8, III-78), rejecting the agreement, and specifying Beale's objections to the patents, which included invalidity, limited scope, and in the case of Faitelowitz a complete failure of title. The status of Faitelowitz at no time had been revealed by Templeton, and even his counsel was ignorant of the vesting in the Alien Property Custodian.

3. In December, 1949, Templeton met with Simplot in New York; and, as a result, Troxell prepared a license agreement which was fully executed by defendant and sent to Edmonds (PX 8, III-148). Edmonds refused to even consider the agreement since it put forward the first of the guaranteed payments for one additional year. Edmonds recommended to plaintiff that the agreement not be executed, in spite of Troxell's explanation that originally though it was thought the 1949 crop of potatoes would be available for production the 1950 crop would be the first that could be processed (PX 8, III-167).

Troxell then proposed to Edmonds that he prepare a new draft in order to determine where the parties "do not have a meeting of the minds" (PX 8, III-170). Edmonds did not reply, and that ended their exchange.

Plaintiff restricts its cause of action solely to the "business understanding" arising exclusively out of the March, 1949, meeting. Templeton prepared his "Heads" right after this meeting while it supposedly was fresh in his mind. At page 27 of its Main Brief, plaintiff lists the obligations (we assume of the March, 1949, meeting) imposed upon it. We will re-examine some of these so-called "obligations" of plaintiff:

(a) "a) a license under all its U.S. patent rights;" (Plaintiff had no rights at that time.)

(b) "b) an obligation actively to perfect and protect those rights;" (This was not covered in the "Heads".)

(c) "c) refraining from licensing another (R. T. French excepted) nation-wide if defendant met certain conditions;" (In the "Heads" plaintiff certified its exclusive right to license others under the patents. With Bunimovitch as joint owner, this phrase is absolutely meaningless. Also, the French license is not mentioned.)

(d) "d) refraining from licensing another in Idaho;" (Not covered in "Heads" -- origin, the Troxell draft.)

(e) "f) a most-favored licensee position for defendant " (Not in "Heads" -- origin, the Troxell draft.)

(f) "g) a guarantee against infringement of the patents of others;" (Not in "Heads" at all.)

(g) "h) an assured license for the entire life of any licensed patent;" (Plaintiff had no patents at this time.)

At this point, by way of contrast we should point out the principal differences between the Troxell draft (PX 8, III-149) which he prepared following his advice from Beale, and the "Heads" (PX 8, III-43) and Edmonds' draft (PX 8, III-60).

Plaintiff makes the statement, devoid of support in the record, that counsel were consulted for the sole purpose of putting into a formalized document customary and routine license provisions unique to the field of patents. Perhaps the court can take judicial notice that the lawyer really is not relegated to the scrivener's role in serving his client. We believe these provisions from the Troxell draft evidence the proper function of the attorney -- not to remake the parties' understandin but rather to put into the contract the protective provisions that will insu to his client the benefits for which he has bargained.

Troxell provisions not found in "Heads" or Edmonds' draft:

(a) Broadening the license to cover products or commodities other than potatoes utilizing the patents.

(b) A warranty by plaintiff of exclusive licensing rights to Volpertas and sole ownership of Rivoche.

(c) A license to manufacture anywhere in the United States, territories or possessions and to sell to the U.S., the Army for use in the U.S. or for export to any country, and to sell and export to any foreign country, where plaintiff does not hold a patent.

(d) Any improvement patents of plaintiff shall be included in the license, but shall not extend period to pay royalties, unless actually utilized by defendant.

(e) Since the 1949 potato crop was not available, production contemplated in 1950, not 1949.

(f) An exception to defendant's obligation to disclose improvements, permitting defendant to withhold processes distinguishable from license patents and which would entitle defendant to issuance of a patent thereon.

(g) Change from plaintiff's "high standards" of quality to "minimum standards" and defining the term.

(h) Redefining basis for royalty to sales f. o. b. manufacturing plant, after deducting freight costs from plant and brokerage fees paid.

(i) Permitting plaintiff's examination of defendant's records by a C. P. A., but at plaintiff's sole expense.

(j) (1) Revision of royalty and minimum tonnage provisions -- defendant to lose "exclusive license" if it fails to meet minimum requirements, but nevertheless to retain "non-exclusive" license; plaintiff at no time to license a manufacturer in Idaho, and none to be granted to others at a lesser royalty.

(2) That the R. T. French license permit no processing in Idaho, and shall not place defendant at a competitive disadvantage.

(k) Any development of new process, not acquired by plaintiff, defendant can cancel instead of agreeing to or arbitrating a revised royalty rate.

(l) Any other licensees under Faitelowitz, and competitive disadvantage results to defendant, royalty adjusted to eliminate disadvantage. (To protect against Bunimovitch joint ownership.)

(m) Under "Heads" plaintiff merely assumed liabilities for infringement of other patents. Troxell provides defendant be defended by plaintiff at the latter's cost, and provides proper notice details. In event of judgment of infringement against defendant, plaintiff to pay judgment and to provide financial resources in U. S. to indemnify defendant.

(n) Termination option in two years.

(o) Option in plaintiff to cancel on two years discontinuance of defendant's operations, tolled by force, majeur labor difficulties or causes beyond its control, etc.

(p) Either party terminate if anti-trust suit brought by U. S.

(q) In event of any termination, the obligation of plaintiff to defend against infringement action, etc., shall continue for the period of limitations within which infringement suit could be filed.

(r) Courts of Idaho have jurisdiction in suit between the parties. Contract interpreted under Idaho law.

(s) A detailed and binding arbitration provision, leaving no gray areas as found in Edmonds and the "Heads".

(t) Assignment by plaintiff to American company if defendant protected under infringement provision. American company not to engage in manufacturing; otherwise, no assignment by either without consent of other.

Most of the provisions above set forth appear in Troxell's letter to Beale, copy to Templeton, August 9, 1949, (PX 8, III-118-121, inclusive).

Plaintiff argues extensively, and cites some authority, that partie[s] need only agree on essential terms. It oversimplifies the essential area[s] of agreement that must appear in an involved, complex licensing agreement. We believe the inclusion by Troxell in his letter of April 9, 1949, and his draft of agreement of the aforesaid conditions will establish to the complete satisfaction of the court that so many matters were unresolved between the parties, to reach an enforceable agreement the court would have to write the contract between them.

D. NO ENFORCEABLE, EXPRESS ORAL AGREEMENT WAS REACHE[D] BETWEEN THE PARTIES.

The negotiations between the parties remained only that, and no

meeting of the minds of the respective parties with respect to the essential elements of a contract existed.

Brothers v. Arave, 174 P. 2d 202 (1946). Appellants sued to quiet title to real property allegedly purchased under contract from respondents. Respondents denied appellant's title. The court ruled that no contract was created absent a meeting of the minds. Cited with approval was Phelps v. Good, 96 P. 216 (Idaho), as follows:

> "In order to constitute a contract there must be a distinct understanding common to both parties. The minds of the parties must meet as to all of its terms, and, if any portion of the proposed terms is unsettled and provided for there is no contract."

Hale v. Dolly Varden Lumber Company, 230 P. 2d 841 (1951). One party alleged the contract was made when the parties orally came to an agreement, the other alleging it was made when the parties signed the written contract which supposedly embodied the oral agreement:

> "It is essential to the validity of a contract that the parties should have consented to the same subject matter in the same sense. They must have contracted ad idem * * * to be final, the agreement must extend to all the terms which the parties intend to introduce and material terms cannot be left to future settlement.
>
> * * * * * * *
>
> "There can be no contract unless the minds of the parties have met and mutually agreed. Consent is not mutual unless all the parties agree upon the same thing in the same sense. The minds of contracting parties must draw together and become as one touching the subject matter and the terms and conditions before a contract can be consummated." (Emphasis ours.)

Of particular significance because of its strong similarity to

dealings between the parties to this appeal is Rubsam v. Harley C. Loney Co., 117 F.Supp. 164 (1953), affirmed at 217 F.2d 353, cert. denied, 350 U.S. 833, 76 Sup. Ct. 69. This was an action for injunctive relief for invasion of an exclusive licensing agreement and for an accounting of royalties allegedly due on an implied licensing agreement. In determining no implied contract existed, the court stated:

> "The plaintiff further claims that all of the elements of an offer, acceptance and subsequent conduct form the basis of an implied contract, and amply appear from the evidence in the case.
>
> "It is conceded that no formal license on Rubsam patents in the service field was ever signed or executed as a contract by the parties to this litigation.
>
> "From the evidence submitted in relation to the existence or nonexistence of an implied license between the parties herein, we find postponement of the making of an offer; attempts by the parties to get together on an agreement an expressed desire on the part of Rubsam to stay out of the service field with his type of weights; the possibility of a final agreement contingent upon the application of a low price to large consumers; completely divergent views by each of the parties as to the function of the hole in the clip; a constant controversy between the parties, and a repeated denial by Loney of the validity of Rubsam's patent No. 2,137,146; an acknowledgment by Rubsam that Loney considered Rubsam's patent No. 2,137,146 invalid; the conduct of Rubsam and his counsel in notifying five of Lone's customers of the infringement of his, Rubsam's, patent on the hole in the clip, No. 2,137,146, and the conduct of Rubsam in placing Loney in the category of a selling agent in the production field.
>
> "From the foregoing analysis of the evidence, it is impossible to perceive in the conduct of these parties that degree of mutuality of understanding that is necessary to imply a license. Here is a background rampant with uncertainty and indecision upon a subject matter constantly under accusation of patent invalidity by one of the parties. When, as here, doubt and difference prevail in the minds

of the parties, this court cannot, and will not, imply a contractual relationship between them.

* * * * * * *

"In conclusion, it has been stated by counsel for one of the parties that:

> 'The history of the relationship between the parties has been stormy and wordy, as is evidenced by the volumes of correspondence between them, only a small part of which has been introduced here in evidence.'

and, to this conservative appraisal of the conduct of the parties, this court can only add that if the minds of the parties ever met on any given proposition in relation to their business dealings, it was an extremely casual and confused meeting, of short duration.

"Such history of confusion and uncertainty reflects critical deviation from any embarkation upon, and adherence to a defined contractual relationship."

In Duval Sulphur and Potash Company v. Potash Company of America, 10 Cir., 244 F.2d 698 (1957), both parties alleged an implied licensing agreement. The plaintiff (Potash) alleged that the implied license provided for royalty to be paid by the defendant (Duval) whereas the defendant alleged an implied gratuitous license with no royalties to be paid. The court said:

> "We hold that there is no implied license of any sort in this case. Such licenses arise only out of the conduct of the parties that indicates accord."

The court found that defendant had at all times refused a license for the patent involved because it was convinced its process was not an infringement. Duval's rejection of an express license with royalties negatived an agreement upon an implied license to the same effect.

Defendant denied plaintiff's rights, claimed a right to use its process regardless of the patent, and disregarded all claims of plaintiff. As to this the court said:

> "To create an implied agreement, one must have a meeting of the minds as in any contract, the variance from an express agreement being only the character of the evidence used to establish it."

To the same effect see Core Laboratories v. Hayward-Wolff Research Corporation, 136 A. 2d 553 (1957).

The plaintiff relies to a large extent on the case of Mantell v. International Plastic Harmonica Corp., 55 A. 2d 250, 173 A. L. R. 1185 (N. J. 1947) for the proposition that the court will read into an agreement essential elements in contemplation of the parties yet not specifically included. This case easily may be distinguished from the case at bar for the reason that an explicit, detailed written contract was actually executed by both parties to the agreement. Involved was a distributor's contract for the sale of the manufacturer's output of a new type of harmonica. The only detail in doubt before the court was the price of the product to the distributor. The court had some yardsticks in the contract to measure the obvious intent of the parties. For one thing, the price to be charged by the distributor was set. The price to be charged to the distributor could not exceed those given to "any other distributor". The obvious intent was to maintain the distributor's margi between his cost and his selling price. Under the peculiar circumstance of this case the court found:

> "* * * the stipulation itself suggests a fair and reasonable price standard, applied as the circumstances became known and were evaluated. If it be deemed a mode for ascertaining the price, it is a matter of form rather than of substance, subsidiary and incidental to the principal purpose of the agreement, and treated virtually as a promise to sell for a fair price, and the contract effectuated accordingly."

The case of People v. Interstate Eng. & Con. Co., 58 Idaho 457, 75 P. 2d 997 (1937), likewise must be given a qualification not apparent from plaintiff's brief. Plaintiff contends that it stands for the proposition that if an agreement be sufficiently definite to ascertain the intent of the parties the court may enforce it. However, in this case the court merely found sufficient evidence in the record, with full performance by the plaintiff, to sustain a judgment for it. We note this statement from the court at page 463:

> "* * * The rule so strenuously contended for the appellant Triplett that: 'If an agreement be so vague and indefinite that it is not possible to collect the full intent of the parties, it is void; for neither the Court nor the Jury can make an agreement for the parties.' must work both ways; * * *."

Plaintiff relies on Pennsylvania Co. v. Wilmington Trust Co., 166 A. 2d 726 (Del. 1960) for the rule that even where parties leave "necessary details to implement the agreement" to be worked out by their attorneys, which fail of accomplishment, equity nevertheless will enforce the agreement. Upon examination, the facts here show no parallel to the present litigation. There by letter exchange, every single detail concerning the sale of the stock including number of shares and amount to be paid was specifically set forth and agreed upon in writing. The

details left to the attorneys was the formal approval of the board of directors and approval, if necessary, of the Interstate Commerce Commission. It is obvious that the court did not have to write a contract for the parties in this case, as it would have to do in the present appeal to find an enforceable understanding.

Further, plaintiff relies on the Idaho decision of McCandless v. Schick, 380 P. 893 (Idaho 1963) for the rule that the reduction to formal writing is not necessary, although agreed upon, where an oral contract has been made. We have no quarrel with this statement, but we refer the court to the actual holding in that case. There was a writing here, the standard form of earnest money receipt and agreement, which contemplated subsequent memorializing on a formal basis. This was a simple agreement for purchase and sale of a farm and every detail was spelled out minutely, excepting only for payment of the balance of the purchase price. The agreement specified this to be paid "at one-third gross crop per year". Farming land being the subject of the agreement and the words having a clear, understandable and acceptable meaning in farm practice, the court, of course, had no trouble in enforcing the agreement. Contrary to plaintiff's notion, the contract was written, not oral.

E. NO QUASI-LICENSE MATERIALIZED FROM THE NEGOTIATIONS BETWEEN THE PARTIES.

A very brief portion only of plaintiff's brief is devoted to the argument that Templeton's disclosures resulted in an implied obligation

on the part of the defendant to pay. The court in its findings did state that plaintiff supplied the defendant with "technical information of some benefit" (R 49 - Findings of Fact IX). We submit that upon detailed analysis this finding is not supported by the record. Plaintiff claims the "know how" disclosed to defendant at the demonstration in Caldwell is the basis for its claim of unjust enrichment. Templeton's "know how" is subject to the following colloquy:

> "Mr. Hawley: Q. Now, in connection with the demonstration, can you tell me whether there was anything shown or demonstrated in the laboratory there that was not readily ascertainable in the printed patents that are involved in this suit?
>
> "Mr. Templeton: No, I don't think there was." (T IV-912)

Plaintiff relies on three cited Ninth Circuit decisions, the latest being Engelhard Industries, Inc. v. Research Instrumental Corporation, 9 Cir., 324 F. 2d 347 (1963). There the court held that information subsequently contained in a patent disclosed confidentially prior to the issuance of the patent would qualify for a claim of unjust enrichment, based upon the profits resulting from the acceleration of production by reason of the disclosure. A short review of the patents in suit is therefore necessary before this rule can intelligently be applied.

Faitelowitz was issued May 31, 1938; Volpertas, July 4, 1944; and Rivoche, August 29, 1950 (R 43 - Findings of Fact III). Rivoche was based on prior British patents issued in 1948, the Rivoche United States application having been amended in 1950 to include claims 17 and 18

in suit (R 18899 - Findings of Fact IV, XXVI). These claims were anticipated by Rendle. The court found claims 17 and 18 not inventive and therefore invalid (R 18899 - Findings of Fact XXVI, XXVII). Plaintiff admits Rivoche did not invent "add-back", the same being covered by the issued Faitelowitz Patent.

At the time of the Caldwell demonstration by Templeton, Kueneman was fully familiar with the add-back principle and with all of the patents in suit (T 974, 981-983, inclusive, 1062; DX 28 A - DX 28 B II 63 to 65, inclusive).

Plaintiff believes it "incredible" that neither Simplot nor Troxell was aware of the demonstration put on by Templeton after the March 1949 meeting. The fact remains that, under oath, they so testified. Simplot testified also that his managers made decisions and ran their end of the business, so it is not as improbable as plaintiff would lead the court to believe that Kueneman as the Director of Research and Development of the Food Processing Division of the defendant would undertake to consent to such demonstration without instruction from Simplot. The inference appears that Dunlap, an employee of defendant who participate[d] in the demonstration, was a witness at the trial. This is not so, and we believe any part Dunlap plays in plaintiff's case be discounted by reading his letter to Templeton of February 24, 1948, (PX III 30 & 31) where eve[n] though then an employee of the defendant company he was soliciting Templeton to set him up in a private business. Templeton, at least until he had firmed a deal with defendant, was holding the bait out to

Dunlap (PX 18, III-33).

> "* * * He (Templeton) is very interested in your penultimate paragraph and in fact would be ready to negotiate on your suggestion regarding potato granules. He would, therefore, be glad to have further particulars of the proposals you have in mind."

Of the information disclosed by Templeton none was of any value to, or utilized by the defendant. The add-back principle of Faitelowitz was covered by a then issued and outstanding patent as was the add-back method of Volpertas. Therefore, under Engelhard, supra, none of this information can be the basis for an equitable claim against the defendant. His demonstration with respect to Rivoche was restricted to the application then pending and covered only freezing and centrifuging. It was not until after the demonstration that he added the two new claims to his pending Rivoche Application, both of which were invalidated by the trial court. Thus, the only process covered by Templeton in his 1949 demonstration, ever utilized by defendant, was add-back which cannot be the basis for a claim of unjust enrichment.

Because the defendant did not go into commercial production until after Templeton's visit, the trial court believed that at least some technical benefit was conferred by Templeton. The record, however, conclusively shows no commercial market existed until that time, so there would be no occasion to get into production. Under the circumstances, there is no legal basis for recovery on the theory of an implied or quasi-agreement under the principles laid down by the court in Engelhard, supra. We will, however, briefly review additional authorities

on this point.

The doctrine had no application where the benefits to a defendant were gratuitously conferred by the plaintiff. Hixon v. Allphin, 281 P.2d 1042 (Idaho 1955).

The successful prosecution of an action for unjust enrichment, as uniformly stated in the cases, where invention is disclosed is dependen upon plaintiffs sustaining the burden of proof with regard to these essentials: 1) Disclosure by the plaintiff to the defendant of a novel idea, i.e., new to the defendant; 2) the disclosure must be made in confidence, under such circumstances that there is implied in law a promise to pay for such information disclosed; 3) the information in fact must be put to use by the defendant to his benefit.

In Berry v. Glidden Company, 92 F.Supp. 909 (N.Y. 1950), plaintiff sued defendant to restrain defendant from using or disclosing a secret formula for which he had made patent application and which the plaintiff alleged he originated and revealed to the defendant in confidence. The court in ruling against the plaintiff said:

> "It is not enough, however, that the defendant used what the plaintiff imparted to it in confidence. Before defendant can be restrained from, or held to account for, such use the plaintiff must further establish that he did disclose something novel to the defendant * * *.
>
> "If the rule were not so restricted it is obvious that by disclosing an idea under delusions of confidence, the person making the disclosure could thereafter prevent the confidante (sic) from subsequently making use of it, even though the idea was well known prior to the date of the disclosure and open to the use of all others in the world."

The court went on to note that the plaintiff's formula had been already anticipated by certain patents, under which defendant had been a licensee for some years prior to disclosure by the plaintiff.

Boop v. Ford Motor Company, 177 F.Supp. 522 (1960), affirmed, 278 F.2d 197. Plaintiff alleged: (1) defendant acquired from the plaintiff by fraud and misrepresentation, certain new and novel ideas; (2) plaintiff contracted to and did sell the idea to the defendant; (3) defendants wrongfully converted to their own use the ideas. Motion for summary judgment granted.

Defendant contended: (1) the ideas were not used by Ford; (2) the alleged ideas of the plaintiff were not new and novel; (3) they were not disclosed to Ford in confidence; and (4) the plaintiff had agreed that his rights would be limited to valid patent claims, none being asserted in this case. The court said:

> "Thus to support any one of the three paragraphs of his complaint, the plaintiff at the trial would have to establish at least the following:
>
> "(1) Disclosure of a new and novel idea, and (2) the use thereof by the defendant.
>
> "If there is no genuine issue as to the material facts upon either the issue of (1) the new and novel character of the ideas, or (2) the use by Ford of the ideas, the existence of disputed facts with respect to any other matters alleged in the complaint is fully irrelevant to the disposition of this motion.
>
> * * * * * * *
>
> "Only those features in the Ford picker which can be found only in plaintiff's pickers and of which it can be shown that Ford * * *. For the plaintiff to prevail, it must appear that the ideas used by the defendant in its pickers came from the defendant.

"Without analyzing these patents in detail, it is apparent that all of the principle features of the plaintiff's two-pickers, and indeed much more, is disclosed by the patents."

The court also took note of advertisements and sales literature concerning units which were on the market prior to the time that plaintiff had made a disclosure to the defendant and which utilized some of the ide which the plaintiff disclosed.

"Now if all the ideas which the plaintiff had in either of his pickers were old and were known to Dearborn, the plaintiff's case must fall."

Quite similar to the case at bar is Mycalex Corp. of America v. Pemco Corporation, 4 Cir., 159 F.2d 907 (1947). Plaintiff sued for an accounting of profits and injunctive relief. Judgment for defendant.

"* * * The plaintiff's case is largely upon suspicion rather than of proof. Such inferences, unfavorable to the defendants, which the plaintiff seeks to draw from the visits to its plant by Pemco officers and the subsequent embarking by Pemco in the field commercially manufacturing and selling glass bonded mica, are overcome by Pemco's previous interest and experiments in this field, inspired by the war, plus the knowledge of Athy from his association and employment with General Electric Company plus the utter failure of plaintiff to prove that the Pemco officers acquired any important secret information from the plaintiff or that defendant actually used in their manufacture of glass bonded mica any material knowledge, (whether secret or not), which was acquired by the officers on their visits (at the instance of plaintiff) to plaintiff's plant."

In Flanigan v. Ditto, Inc., 7 Cir., 84 F.2d 490 (1936), plaintiff sought to recover for breach of express contract and also for breach of confidence for disclosures made and used by defendant. Judgment for defendant.

> "The patent had been issued, whereby whatever of novelty was inherent in it was disclosed to the world -- including Ditto. Such disclosure is the price which the inventor pays the government for the exclusive time-limited monopoly of the invention which it grants the inventor by its patent contract. 35 U.S.C. § 33. * * * If before the issuance of the patent the invention had been revealed in confidence to another who took advantage of it, appropriate relief in a proper action might be accorded. Booth v. Stutz Motor Car Company, 56 F.2d 962, but it does not appear from the evidence that any such advantage of this inventor was sought or taken by Ditto * * *. It was not until after the inventor paid the price which the government exacts for the monopoly it granted to him, to-wit, full disclosure of how to practice the invention, that Ditto assumed to do those things which the inventor here claims to have been an invasion of his rights."

See also: National Welding Equipment Company v. Hammon Precision Equipment Company, 165 F.Supp. 788 (D.C. Cal. 1958).

In Smoley v. New Jersey Zink Company, 24 F.Supp. 294 (N.J. 1938), affirmed 106 F.2d 314, plaintiff sued defendants to require an assignment of patents to plaintiff, to account for profits and for an injunction. Judgment for defendant.

Plaintiff alleged that he had visited the various officers of the defendant and told them of his idea of applying the principal of rectification to the separation of metals.

The defendant alleged that this idea was never divulged to its employees by Smoley; and, in addition, denied that there was anything novel about Smoley's alleged idea.

Defendant in rebuttal of any disclosure by plaintiff introduced evidence showing that its employees had been working on the matter and

had envisioned the plaintiff's idea long before the plaintiff visited the plant. In addition, it introduced into evidence an article published ten years before plaintiff's disclosure which suggested plaintiff's idea.

> "A further condition to recover is that the idea disclosed must be novel. * * * A duty to use an idea already known cannot be created by virtue of the fact that one makes a confidential disclosure of that idea. * * * If the rule were not so restricted it is obvious that by so disclosing an idea under delusions of confidence, the person making the disclosure could thereafter prevent the confidante from subsequently making use of it, even though the idea was well known prior to the date of the disclosure and open to the use of all others in the world."

<u>DeFillippie v. Chrysler Corporation,</u> 53 F. Supp. 977 (N.Y. 1944). Suit was brought by plaintiff for accounting for use by defendant of plaintiff's invention, on theory of an implied contract. Complaint dismissed.

> "Assuming that whatever disclosure was made by plaintiff was in strict confidence, I think he has failed to prove that he disclosed anything novel or patentable, or that the defendant had appropriated or used anything that he so disclosed.
>
> * * * * * * *
>
> "In view of what has been said, there could be no implied contract to pay for a device not novel nor used by the defendant."

F. THE UNIFORM SALES LAW OF IDAHO IS NOT APPLICABLE.

1. The Uniform Sales Law of Idaho (Sec. 64-109(4), Idaho Code) has no application to this case.

Plaintiff contends that under this provision where the royalty is not fixed by contract the buyer (defendant) must pay, in the language of

the statute, "a reasonable price".

We first look to the contracts of sale covered by the statute:

> "Contracts to Sell and Sales - 1. A contract to sell goods is a contract whereby the seller agrees to transfer the property in goods to the buyer for consideration called the price. 2. A sale of goods is an agreement whereby the seller transfers the property in goods to buyer for a consideration called a price. 3. A contract to sell or a sale may be absolute or conditional. 4. There may be a contract to sell or a sale between one part owner and other." (Sec. 64-101, Idaho Code)

Patents are not within the meaning of the term "goods" as used in the statute. In the annotation, 132 A. L. R. 532, the term goods means property having a mercantile characteristic and the subject of trade in commerce. Patents obviously are not in this category.

A patent is not a chattel personal as claimed by the plaintiffs, but is a chose in action. According to Williston on Sales, Vol. 1, Sec. 37, Rev. Ed. 1948, "the words of the statute (the Uniform Sales Act) have never yet been extended by any court beyond securities which are subjects of common sale and barter and which have a visible and tangible form". A strong case holding a patent not within the Uniform Sales Act is Beacon Oil Company v. Perelis, 160 N. E. 892 (Sup. Ct. of Mass. 1928). The court said:

> "* * * The words of the statute have never yet been extended by any court beyond securities which are subject to common sale and barter, and which have a visible and palpable form. To include in them an incorporal right for franchise, granted by the government, securing to the inventor and his assigns the exclusive right to make, use and vend the article patented; or a share in that right, which has no separate or distinct

existence at law until created by the instrument of assignment would be unreasonable to extend the meaning and effect of words which have already been carried quite far enough. * * *."

The legal effect of a patent is the right to restrain others from manufacturing, using or selling that which the inventor has invented, and this the law will enforce. It is a right, not goods or tangible propert subject to common sale and barter.

In this case we have a purported license agreement only -- a licer in defendant to use the patents involved in the suit. The owner of a paten who grants a license, retains title to the patent in trust for the licensee. Consequently, this also is a right which is not subject to common sale an barter and does not have visible or tangible form.

In Empire Laboratories, Inc. v. Golden Distributing Corporation, 164 N. E. 772 (Sup. Ct. of Mass. 1929), we find at page 773:

> "* * *'Merchandise' is, it has been said, a word of large signification. * * *. It is however limited to 'subjects of commerce' goods, wares, commodities, having a 'sensible, intrinsic value,' * * * or tangible property which may be the subject of sale * * *. Although Promissory notes and shares of stock have been held to be merchandise under the statute of frauds, * * * the words of the statute of frauds have never been extended beyond securities which are the subjects of sale and 'which have a visible and palpable form'; and these words do not include a patent right granted to an inventor. * * *."

See also: Williston on Sales, Vol. 1, Sec. 67, P. 171, Rev. Ed. 1948; Meehan v. Sharp, 151 Mass. 564, 24 N. E. 907 (Sup. Ct. of Mass. 1 Vincent v. Vieths, 60 Mo. App. 9 (St. Louis Ct. of App. 1894); Banta v. Chicago, 172 Ill. 218, 264, 50 N. E. 233 (Sup. Ct. of Ill. 1898), 40 L. R. A

611; Howe v. Jones, 57 Iowa 139, 8 N.W. 451 (Iowa Sup. Ct. 1881).

The cases cited by plaintiff in support of its contention that the Uniform Sales Act applies to a patent license are not on target -- none involve property, other than those normally thought of as merchandise moving in the channels of trade and commerce.

G. APPELLANT'S REFERENCE TO OTHER LITIGATION INVOLVING APPELLEE IS IRRELEVANT AND PREJUDICIAL.

Plaintiff refers to Simplot's testimony as a "tale", it being clear the term is used in its meaning of an intentional untrue recital or falsehood rather than in the sense of a narrative, and cites three cases: J. R. Simplot Co. v. Dallas Rupe & Son, Inc., 369 P.2d 445 (Nev. 1962); Archer v. J. R. Simplot Co., 10 Cir., 289 F.2d 596 (1961); and United States v. J. R. Simplot Co., 192 F.Supp. 734 (Utah 1961). Transparently, these cases are not cited to assist this court in applying the law to the case, for they contain no statement of applicable law. Plaintiff's motivation is obvious. Rather than genuinely to assist the court in its determination, this is a crude and unlawyerlike attempt in execrable taste to go again outside of the record, hoping to prejudice the defendant in the eyes of the court.

Perhaps this portion of plaintiff's brief should not even be discussed; however, since plaintiff brings the matter up, it is interesting to note that in the Rupe and Archer cases written contracts were involved, with alleged oral modifications. In Rupe, there was a detailed written contract and the question involved an oral financial commitment as being sufficient

to constitute performance of the agreement. In Archer a specific written joint venture contract was involved. The only question was whether adequate notice had been given to the plaintiff Archer of the defendant's desire to withdraw from certain oil leases so that Archer would have opportunity to take them back. The court found both oral and written notices had been appropriately given by the defendant Simplot Company.

The case of United States v. Simplot, supra, was a perjury indictment against J. R. Simplot, growing out of the Archer case. After losing his lawsuit, Archer and counsel went to the United States Attorney and before the federal grand jury and got an indictment against J. R. Simplot which was subsequently dismissed by Judge Christensen and which never was again filed.

While out of order, we should also mention plaintiff's citation of N. L. R. B. v. J. R. Simplot Company, 9 Cir., 322 F. 2d 170 (1963). It appears in plaintiff's brief for the proposition that a contract to negotiate is binding. This was a labor dispute, and the sole question was whether the defendant was deprived of due process of law by the failure of the Board to grant a hearing before setting an election aside. This, of course, involved the construction of a specific statute, and it is absolutely and completely inappropriate as a citation in support of the proposition urged. We can then only again conclude that it is cited merely to emphasize the fact that the Simplot Company occasionally is involved in litigation, for its prejudicial effect.

H. ADVICE AND RECOMMENDATIONS OF DEFENDANT'S COUNSEL A CONDITION PRECEDENT TO THE FORMATION OF A LICENSE AGREEMENT.

From the inception of negotiations, all parties recognized the importance of legal advice. Now, because defendant wisely listened to the counsel of Beale and Troxell, the former is directly and the latter indirectly charged with bad faith, in destroying the formalizing of a contract between the parties.

Plaintiff devotes four pages of its brief (51-54) to pure speculation on the various roles that Beale might have played in the negotiations. The point remains, he provided his client with legal opinions that showed plaintiff's offer of "the umbrella of a patent position" a fraud. What did Beale's opinion develop in this respect?

1. That plaintiff had no title to Faitelowitz, title being in the Alien Property Custodian, and could grant <u>no</u> license thereunder. Further, that to grant defendant an exclusive license plaintiff must (a) divest the APC title and (b) acquire the Bunimovitch 75% interest. Edmonds confirmed this:

> "* * * (Plaintiff) cannot now grant a license under the Faitelowitz patent. That (plaintiff) would have to institute divestment proceedings and acquire the Bunimovitch interest is correct only to the extent that (plaintiff) would have to do those two things in order to grant an exclusive license * * *." (Edmonds' letter to Beale, June 11, 1949 - PX 8, III-111)

2. That Faitelowitz was anticipated by the prior art -- in particular, the Rendle patent.

3. That Volpertas and Faitelowitz were not basic patents, probably invalid, and if not, narrow in scope.

4. Rivoche was only an application, and if maturing into patent, would be invalid, or at least of narrow scope.

Since Judge Taylor found no infringement of Faitelowitz and Volpertas, and therefore did not rule on the invalidity of those patents; and, likewise, since he found claims 16 and 17 of Rivoche invalid (these having been added in 1950 to the application), plaintiff flatly asserts that Beale's opinion was "as a matter of law, capricious and arbitrary". No authorities are cited to support this statement. It further argues that these matters were not "fundamental" flaws to plaintiff's offer, and thus Beale's advice to his client was erroneous, not in good faith and an unauthorized attempt to remake the "understanding".

At the outset plaintiff obviously is rowing upstream with this argument, since the trial court found no merit to its patent action.

We will re-examine the law applicable to agreements, conditioned upon advice of counsel.

The position taken by plaintiff is that where, particularly in real estate agreements calling for marketable title and in construction contrac where a third person has authority to make certain decisions, good faith and reasonable judgment is required on the part of the third party. Plaintiff admits the problem facing the patent attorney in reviewing a license contract is as simple, stating he must "evaluate both engineering and legal criteria to advise his client." It is, therefore, simply not a

mechanical matter like counting gravel or examining the title to a piece of real property. The cases cited by plaintiff in support of this proposition generally show that the third person, whether he be an attorney or otherwise, must exercise his judgment using good faith. In Pacific Telephone & Telegraph Co. v. Davenport, 9 Cir., 236 F. 877 (1916) this court in looking at the attorney's conduct in rejecting the title for his client, the purchaser, stated, at page 880:

> "* * * There is nothing in the record even tending to show that the action of either the appellant or his attorneys in the respects indicated was in bad faith, arbitrary, or in any way capricious. * * *
>
> * * * * * * *
>
> "Passing that consideration, however, the refusal of the appellant to make the purchase being also based on the grounds that the appellee's title to the property was not acceptable to the appellant's attorneys, and the evidence not only tending to show a bad faith or arbitrary or capricious action, in that regard, but that the rejection of title by attorneys for the appellant was based upon facts which were clearly debatable, and at least not free from doubt, we regard it as clear that the decree enforcing the specific performance of the contract cannot be sustained * * *.
>
> " 'It is perfectly competent for the parties to stipulate that the title of the vendor shall be such as will be pronounced good and merchantable by an attorney, title or trust company, or other third person, and the purchaser will not be required to take a title not so pronounced good so long as there is good faith, although the court may deem it good under the law. Under such a contract the approval or disapproval of such third person is conclusive, if made in good faith, and with no improper motive, although in the opinion of the court the title may be good as a matter of law.' " (Emphasis ours.)

The case cited by plaintiff, Nelson Bennett Company v. Twin Falls

Land & Water Company, 14 Idaho 5, 93 P. 789 (1908) is an extreme one where the estimates of the engineer for one of the parties was to be determinative as to amounts. The trial judge actually found bias, dishonesty and fraud on the part of the engineer. The Idaho Supreme Court in Puget Sound Nat. Bank of Tacoma v. C. B. Lauch Const. Co., 245 P. 2 800 (1952), stated the general rule on construction contracts also to be, at page 805:

> "The contract in question provided that the painting job should be done to the full and complete satisfaction of certain specified persons. This means satisfaction to a reasonable person * * *."

There is an extensive annotation following the reported case of Larson v. Thompson, 215 N. W. 927 (S. D. 1927), 57 A. L. R. 1246. In the reported case the purchaser was not required to accept the title doubtful to his attorney. The court stated at page 1250:

> "* * * If there are defects that will form the basis for objection, and which will be objected to by most, if not all, reputable and competent attorneys to whom the abstract may be submitted, then the purchaser ought not to be compelled to accept such title * * *."

As detailed in the annotation to this case, there are decisions tha the attorney's opinion if made in good faith, is conclusive. Other cases hold the approval of the attorney is not a condition precedent to the right to enforce the contract, but rather it is sufficient if the vendor shows tha in fact the title was marketable and that the attorney acted in an unreasor able manner.

In any event, this court has determined that an attorney need only

act in good faith, and, if so, his opinion shall be conclusive.

The suggestion is made that at no time did Beale communicate his opinion to defendant. Plaintiff knows better, and the record so shows. Beale's opinion on the patents was given by Troxell to Mr. Templeton (T 1319, Vol. VII), and both Templeton and his attorney received Troxell's letter of April 6, 1949, summarizing in brief Beale's objection to the status of the patents. (PX 8, III-78-79) In addition, in August of 1949 Troxell reviewed these matters with Templeton and in the same month Templeton spent some hours with Beale. Surely, therefore, it comes at a late date for counsel to plead ignorance of Mr. Beale's opinion.

Plaintiff raised no question at the trial about the good faith of Beale's advice to his client, and, obviously, a reading of the record shows that it assumes he had given the advice which appears in Troxell's letter to Templeton. Plaintiff, of course, if they question all the good faith of Mr. Beale, had the right of discovery to request these opinions if they deemed them material. Further, he was present during the entire trial, had plaintiff desired to put him on the stand to determine his good faith or lack of it.

I. LIMITATIONS, IN BAR OF THE ACTION.

Plaintiff ties its case to an oral "understanding" made in March of 1949. Suit was instituted February 1, 1960, eleven years after the purported contract was made.

The Idaho statute of limitations governing oral agreements controls:

> "Section 5-217. Action on Oral Contract. -- Within four years; an action upon a contract, obligation or liability not founded upon an instrument of writing." (Idaho Code)

It is the defendant's view, as supported by the determination of the trial court, that no enforceable agreement ever materialized betwee[n] the parties. We, therefore, in arguing limitations must assume for tha[t] argument, as does the plaintiff, that a contract was made in March, 194[9].

Stripped down to the essence, it is plaintiff's argument, to avoid the bar of the statute, that its action did not accrue until Faitelowitz divested from the ownership of the APC in 1956, the statute running from that date.

The fact remains, however, <u>three mutually exclusive</u> patents were the subject of the alleged license. Suit could be maintained on any one, without regard to the others.

Plaintiff observes the APC acquired Faitelowitz under "clear mistakes of fact", yet there is no evidence in the record to support this. Irrespective, the fact is, as admitted by plaintiff, that at the time the alleged contract was made in 1949 plaintiff could not perform at all. Inconsistently, however, plaintiff asserts that though it expected defenda[nt] to perform under the understanding of March, 1949 (and this is conclusi[vely] established where Edmonds and Templeton refused the Troxell draft for the reason the royalty payment was deferred), it now says defendant's obligation to perform was delayed until the condition precedent -- vestin[g] of Faitelowitz -- was accomplished by plaintiff in 1956.

It would follow, therefore, under plaintiff's theory, that neither party would commence performance until 1956.

It is apparent, also, that the plaintiff at no time would consider the divestment of Faitelowitz as a real factor in its agreement. Troxell attempted to except royalty payments until Faitelowitz had revested (PX 8, III-118), and in his draft of agreement protected defendant from other licensees under the Bunimovitch joint ownership. Edmonds and Templeton expressly rejected these qualifications.

The trial court found that the plaintiff, by refusing to execute any contracts prepared by the defendant, repudiated any supposed agreement. In addition, after the plaintiff refused to sign the December, 1949, Troxell draft, the defendant went forward with its production and facilities, and in 1951 was in open, full production. Templeton in the fall of 1949, and subsequently, advised plaintiff negotiations had terminated, and by 1950 had licensed other processors and appointed Scott as his United States agent, thus putting the plaintiff in a position where it could not perform under the original offer it had made to defendant.

Certainly the last attempt to negotiate a license, and this a non-exclusive one, because others in the interim had been licensed by plaintiff, was in 1952, through Scott's efforts. These negotiations were likewise unsuccessful, no agreement being reached.

The court determined that defendant repudiated any so-called agreement when it went into full-scale production in 1951, which fact was well known to plaintiff, and that in 1954 at the outside, plaintiff

was openly critical of Templeton's attempt to license others under the patents.

The trial court therefore concluded plaintiff's cause of action accrued in 1954 at the latest. The court also found that negotiations had dragged on interminably, only by reason of "Templeton's perserverance and unwillingness to pursue any other remedy".

Plaintiffs have come up now, for the first time, with the theory that the acts of the defendant constituted an anticipatory breach of the agreement, and that it could wait until it had fully performed (by meeting the condition precedent - the divesting of Faitelowitz) before declaring the breach and filing suit.

Following this theory through, there was no time specified within which plaintiff was to regain title to the patent, so under the authoriti a reasonable time would be presumed. The facts show Faitelowitz was returned by the APC in 1956, more than seven years from the date of the alleged oral contract of March, 1949. What occasioned this delay? Where in the record has plaintiff justified this lapse of time? The answer is, the record is silent, and plaintiff cannot give a reasonable explanation for this seven-year wait.

Plaintiff seriously contends that it could delay its own performan indefinitely, and thus toll the running of the statute indefinitely. Howeve it is the law that the party having an affirmative duty cannot take an unreasonable time to perform and is only given a period the equivalent of the period of limitations. Pitzer v. Wedel, 165 P. 2d 971 (Cal. 1946).

The defense of the statute of limitations was raised and the court stated:

> "Where no time of payment is fixed, our courts have held that a reasonable time within which to pay is inferred and that such reasonable time may be coincidental with the statute of limitations. * * *. The law implies that the contract shall be performed within a reasonable time or at least reasonable efforts to perform within such time will be made. * * *. Reasonable diligence and good faith must be required in such instances and it is the duty of the court to hear evidence and therefrom fix time that would be fair."

The statute of limitations was four years and consequently the court fixed four years from the date of the execution of the agreement as a reasonable time within which the contract could have and should have been performed.

In Southworth v. Foy, 201 P. 2d 302 (Nev. 1948), the court ruled the statute of limitations in bar of plaintiff's action, saying at page 304:

> "When a demand is essential, as a condition precedent to an action, it must be made in a reasonable time. The party bound to make it, can not postpone it indefinitely, and by his procrastination keep alive claims that would otherwise become dormant, and grow stale, the enforcement of which would be offensive to the policy of the law and dangerous to the rights of his adversary.
>
> * * * * * * *
>
> "It would be a dangerous precedent it would endanger the estates of the dead; it would render the rights of the living uncertain and insecure; it would open the door for the introduction of stale claims, which it has been well said, have often more of cruelty than justice in them; and it would be violative of the policy of the statute of limitations, and defeat the purposes it was intended to accomplish, if without an explanation of the long delay in making demand, and the unwarrantable delay in bringing suit, after the fruitless demand, until Winston was dead, the statute was held not a bar."

Further, it is not the policy of the law to permit a party against whom the statute runs to defeat his operation by neglecting to do an act which devolves upon him in order to perfect his remedy against another.

See also: 34 Am. Jur., Limitations of Actions, § 116, P. 96; Williston on Contracts, Rev. Ed., Vol. 6, § 2041, P. 5718, 5719; 54 C.J.S., Limitations of Actions, § 200, P. 205.

In Ginther v. Tilton, 23 Cal. Rep. 601 (1962), limitations was applied:

> "It appears without contradiction that defendant's promise to perform was conditioned on the time of the happening of the event wholly within the control of plaintiff. Where a plaintiff's right of action depends upon a preliminary act to be performed by himself he cannot suspend indefinitely the running of the statute by delaying performance of this act."

See also: Stafford v. Oil Tool Corporation, 284 P. 2d 937 (Cal. 1955).

J. LACHES ON THE PART OF APPELLANT OPERATES AS A BAR TO RECOVERY.

The record is unquestioned that plaintiff had full knowledge in 1950 that defendant was going forward with granule production, and it was well aware of defendant's processes and the extensive expansion in its plant, facilities and production. As early as June, 1950, Templeton was contending defendant's processes infringed the three patents. Yet plaintiff sat on its hands until February, 1960, when this suit was filed.

The only explanation it has is that it was derelict in waiting to

divest Faitelowitz in 1956; that Simplot and Beale kept him dangling on the end of the string with the illusory hope of an ultimate license. The trial court, however, had a different view of which party to this suit "perservered" in this respect. (R 50 - Findings of Fact)

Further, there is not even an attempt to explain why suit was not initiated at least in 1956 after the revesting of Faitelowitz.

Our answer to the argument that limitations tolled until plaintiff regained the Faitelowitz title likewise applies to laches. Moreover, not only were the patents mutually exclusive, but by Templeton's admission Faitelowitz was not a commercial process, <u>and was never used by the defendant</u>.

Plaintiff attempts to create an estoppel by Mr. Beale's conduct. The deception that "Mr. Beale continued his meeting with plaintiff's attorney" in 1951 and "even more important * * * resumed his meetings with plaintiff's attorneys" after 1956 (Plaintiff's Main Brief, 78) cannot go unanswered.

The facts are: Beale saw Edmonds for a brief time in June, 1949; Templeton for a few hours in August, 1949, and Fisher for a few minutes in 1956 -- all at the instruction of the plaintiff. Fisher, of course, got a "no" on his request for a non-exclusive retrospective license (PX 8, III-223).

This conduct would not seem adequate to remove the staleness from plaintiff's suit.

In a recent decision the Idaho Supreme Court, <u>Finucane v. Village</u>

of Hayden, 384 P. 2d 236 (1963), the doctrine of laches was defined:

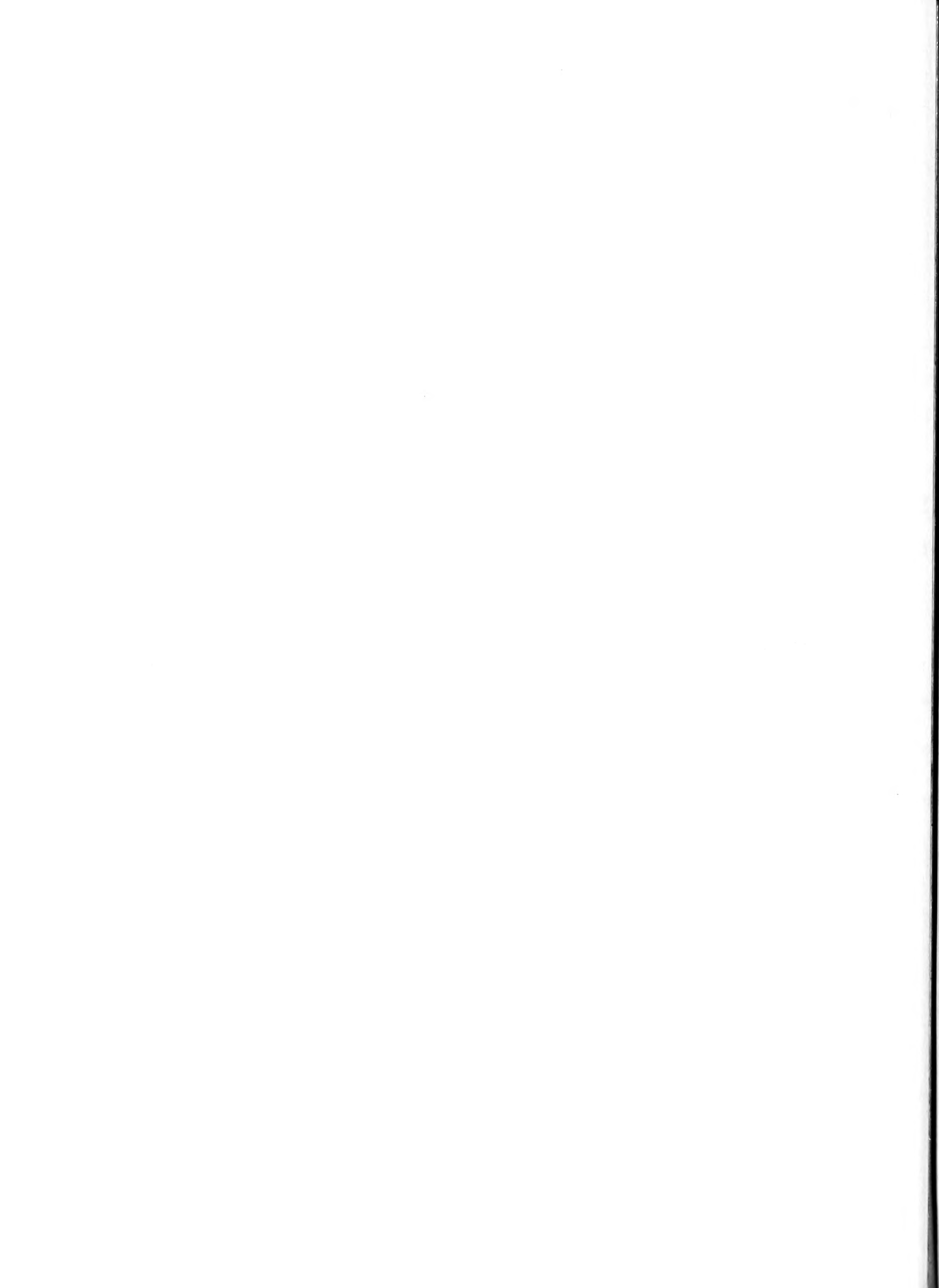
> "The defense of laches is a creation of equity and is a specie of equitable estoppel. * * *.
>
> "The necessary elements of laches are: (1) defendant's invasion of plaintiff's rights, (2) delay in asserting plaintiff's rights, the plaintiff having had notice and an opportunity to institute a suit, (3) lack of knowledge by defendant that plaintiff would assert his rights, and (4) injury or prejudice to defendant in event relief is accorded to plaintiff or the suit is not held to be barred. * * *."

See also: Flora v. Gusman, 279 P. 2d 1067 (Idaho 1955).

In Hillcrest Irrigation District v. Nampa and Meridian Irrigation District, 57 Idaho 403, 66 P. 2d 115 (1937), was an action to quiet title in the plaintiff. Plaintiff purchased certain water rights in 1913 and made application in the latter part of 1913 for a permit to change the point of diversion to a point much further up the stream from where the water had theretofore been diverted. Hearing was subsequently had and permit was granted and the transfer of diversion made. The court held the doctrine of laches would apply and quieted title in plaintiff, stating:

> "Even though appellant's title may have been originally questionable, or uncertain, nevertheless, respondents have stood by, with full knowledge of all the facts, and for more than twenty years have allowed appellant to proceed on the theory that it had valid title to these water rights and a legal right to have the water diverted from the New York Canal; and in the meanwhile has incurred large indebtedness on the strength of its title and right until now respondents are, and should be, stopped by laches from questioning appellant's title."

Robinson v. Linfield College, 42 F. Supp. 147 (Wash. 1941), affirmed 9 Cir., 1943, 136 F. 2d 805; certiorari denied, 64 Sup. Ct.



262, 320 U.S. 795, 88 L.Ed. 479, was an action by plaintiff as administrator of the estate of Edward S. Ross and Mary C. Ross, deceased, against defendant to recapture title to certain realty within the State of Washington. This action was brought 19 years after the contested transfer of title in 1922. The court held the doctrine of laches must be applied. The court pointed out that Linfield College had received and expended the money involved from the sale of the property, and that plaintiff waited until the property in question had greatly enhanced in value. The court states the purpose of laches is to guard and protect against the injustices of a stale demand and courts of equity have applied this doctrine to protect defendants from a plaintiff's unexcused delay in bringing the suit.

Chilberg v. City of Los Angeles, 128 P.2d 693 (1942). An action for rescission of an easement granted to the City of Los Angeles by plaintiff. In 1938, plaintiff executed a deed to the City of Los Angeles, conveying an easement of right-of-way across his land. Plaintiff claimed that he was induced to sign the deed through misrepresentation and fraud. The defendant claimed the action barred by laches as plaintiff waited for only three years until 1941 to give written notice of rescission. The court stated:

> "The application of the doctrine of laches is not dependent upon the delay of sufficient duration to call into operation the Statute of Limitations. If in the course of inexcusable delay in the assertion of a right, changes occur in the subject matter of the transaction in suit or in the relative position of the parties thereto, as a result of which it is impossible to place the parties

> in status quo, and the enforcement of the right work inequity, relief will be denied because of laches. Prejudice to defend may prevent relief whether the change in circumstances is the result of delay itself, or is due to the voluntary act of the defendant." (Emphasis ours.)

Whitman v. Walt Disney Production, Incorporated, 263 F. 2d 229 (1958), was an action for infringement of patents. This particular patent was issued to the plaintiff on March 30, 1937. Prior to 1939, plaintiff saw a motion picture produced by the defendant and determined that the process used to produce it infringed his patent. A civil action was filed on September 30, 1939, involving the same plaintiff and the same defendant. This action was dismissed by an order of that court dated December 15, 1939, and consented to by the plaintiff. Another action was filed May 8, 1940, and dismissed on March 30, 1943, without prejudice for lack of prosecution. On July 30, 1953, the present suit was filed and 18 months later an alias summons was issued which was served on January 19, 1955. The defendant moved for a separate trial on issue of laches. The court held the defense of laches barred the suit. The court pointed out the general rule that one cannot have knowledge of an alleged infringement, and then stand idly by while the infringer embarks on a costly expansion program. It stated mere passage of time cannot constitute laches, but if the passage of time can be shown to have lulled defendant into a false sense of security, and the defendant acts in reliance thereon, laches may, in the discretion of the trial court, be applied. The court relied primarily on the case of

Gillons v. Shell Company, 9 Cir., 86 F.2d 600 (1936), "the leading decision in the circuit" on the defense of laches. The court stated:

> "The general rule is that equity frowns upon stale demand and that in connection with the bar of laches, from the earliest days, Federal Courts have emphasized the distinction between a reasonable and an unreasonable delay in bringing suit -- even within the period designated by the Statute of Limitations."

In Gillons v. Shell Company, supra, plaintiff filed a bill of complaint against defendant for an accounting for alleged infringement of a patent. It appeared that disclosures regarding said patent were made in certain government and scientific publications which were available to the defendant. The evidence disclosed the plaintiff was aware of the infringement as early as 1920 and 1921 and the action was not instituted until 1930. The court held that the defense of laches was applicable and the suit for infringement was dismissed. The court stated:

> "Equity frowns upon stale demands. She will not aid one who has slept on his rights. She turns her back on a litigant who has been guilty of unreasonable delay in filing suit.
>
> * * * * * * *
>
> "Independently of any statute of limitations, courts of equity uniformly declined to assist a person who has slept upon his rights unreasonably long, and shows no excuse for having done so."

General Electric Company v. Sciaky Brothers, Inc., 187 F.Supp. 667 (Mich. 1960). Plaintiff, G.E., brought action for infringement of two patents against defendant. The defense of laches and estoppel advanced by defendant were held applicable. In arriving at its decision, the court

pointed out that G. E. had dealt with defendant since 1940 and was well acquainted through trade associations, magazine articles, direct negotiations, inventions, social gatherings and exhibits of defendant's equipment and endeavored to arrange with defendant some kind of cross licensing, but failed to do so. Not until 1958 did G. E. claim infringements although defendant's machines used the accused features which had been discussed between them since at least 1948. During G. E. 's silence, defendant built up an extensive business from 1948 to 1956, and it was self-evident that reliance of G. E. 's silence would result in substantial injury to defendant. The court stated:

> "We define laches to be the inequity done a party who has changed his position in reliance on an adversary's unreasonable and unexplained delay (or neglect) to seek to enforce a right at a proper time.
>
> * * * * * * *
>
> "The law is well settled that, where the question of laches is an issue, the plaintiff is chargeable with such knowledge as he might have obtained upon inquiry, provided the facts already known by him were such as to put upon a man of ordinary intelligence the duty of inquiry.
>
> * * * * * * *
>
> "The fact remains that one having patent rights can not treat the rights given thereby lightly without having the defect of one's own actions used against him when he seeks to claim infringement."

Brennan v. Hawley Products Company, 7 Cir., 182 F.2d 945 (1950), was an action for patent infringement against the defendant for infringement of patent. This patent was issued to plaintiff on August 22

1933. The complaint, charging infringement, was filed on March 31, 1948. Defendant asserted the affirmative defense of laches. The court in dismissing this action on the theory of laches, pointed out that plaintiff had had full knowledge of defendant's infringement. In addition, the plaintiffs were under no handicap or disability -- financial or otherwise -- which prevented them from asserting and vindicating their rights under the patent. No evidence was disclosed to justify this long delay. The court stated:

> "In the case at bar, the record shows not only a long delay on the part of the plaintiff in instituting litigation on his claim of infringement, but also such a change in the condition of the defendant that it would be inequitable to allow plaintiff to enforce his claim for infringement. Not only has the defendant expended large sums of money in extension of its manufacturing facilities, but two of its most important witnesses have passed away."

See also: Potash Company of America v. International Minerals and Chemicals Corporation, 10 Cir., 213 F. 2d 153 (1954).

Rome Grader and Machinery Corporation v. Adams Manufacturing Company, 7 Cir., 135 F. 2d 617 (1943), was an action for the infringement of patents. The court upheld the defense of laches and dismissed the suit, stating:

> "Defendant has expended great sums in reliance upon plaintiff and its predecessors in action. * * *. At the same time, it has made and marketed other graders which do not infringe and could have entered manufacture upon them if infringement had been promptly asserted and established, but the apparent acquiescence of the plaintiff and his predecessor, neither of whom was under disability or handicap, as the trial court justifiably found from the evidence, led defendants to believe that no

necessity existed to incur the expense of changing over exclusively to the production of other types. Defendant's reliance upon plaintiff's inaction was fortified by the opinion of reputable counsel that his graders did not infringe." (Emphasis ours.)

See also: Delancy Patents Corporation v. John Mansville, 29 F.Supp. 431.

Recently General Electric v. Sciaky Brothers, Inc., supra, was affirmed by the Sixth Circuit on June 20, 1962, at 304 F.2d 724. The court said in affirming this action:

> "Where the unexplained delay exceeded the applicable period of the statute of limitations, injury to the defendant is presumed. In a patent infringement action equitable principles are applied.
>
> "Equity will not aid those who have slept on their rights. The failure of General Electric to take action over the many years constituted laches. * * *.
>
> * * * * * * *
>
> "Whether or not General Electric was guilty of laches was a question of fact to be determined by the trial judge in the exercise of judicial discretion. * * *. We are of the view that the findings of fact adopted by the District Court on this issue are supported by substantial evidence and are not clearly erroneous. They are binding on us. * * *. We think his conclusions of law were correct.
>
> "The fact that General Electric wanted licenses on Sciaky's patents and negotiated with Sciaky on a cross-licensing basis did not in our judgment excuse the long delay in enforcing its own rights. The District Court found that in so doing General Electric was engaged in a 'fishing expedition'. In any event, the negotiations between the parties ceased in 1951 and General Electric took no action until seven years later."

In Tracer Lab., Inc. v. Industrial Nucleonics Corporation,

204 F. Supp. 101 (1962), an action was brought for wrongful acquisition and use of the trade secrets. The court held the action barred by laches, stating at page 103:

> "* * * As has already been pointed out, plaintiff knew of the existence of its cause of action and had available the means of discovering the additional facts needed to prove its case. It has shown no justifiable excuses for delay. On the other hand, this delay has worked a hardship on defendant. In 1950 when the alleged violation of plaintiff's rights first occurred, defendant was a small company, newly organized and starting business on a small scale, largely on borrowed capital. In the next eight years it built up its business to the point where its annual sales and its investment in plant and facilities amounted to millions of dollars. Meanwhile, it has become more difficult to obtain the evidence needed by the parties, especially as to what actually occurred in 1949 and 1950. Witnesses have forgotten facts or are not so readily available and some documentary evidence appears to have been destroyed. This action was commenced almost four years ago and despite diligent efforts of counsel, discovery has not yet been completed by either party. Plaintiff should have brought its action promptly when it knew its rights were being violated. It cannot expect relief from equity when it sleeps on its rights and permits defendant in reliance of such inactivity, greatly to expand its business and then confronts defendant with a costly and burdensome action."

A final point -- 50 U. S. C. A., Appendix, § 9(a), specifically sets forth a procedure for releasing property mistakenly acquired by the Alien Property Custodian. The record is devoid of any explanation as to why this procedure was not promptly taken advantage of by the plaintiff; and there is, of course, no explanation of the time lapse from 1949 to 1956 when ultimately the Alien Property Custodian returned title to Faitelowitz to the plaintiff.

Under the decisions of the federal courts, it is submitted the facts in this litigation present the classic picture for application of the doctrine of laches.

K. PLAINTIFF HAD NO LEGAL STANDING TO MAINTAIN SUIT ON THE FAITELOWITZ PATENT AND THE FAILURE TO JOIN AN INDISPENSABLE PARTY PLAINTIFF DEPRIVED THE COURT OF JURISDICTION.

The above point was asserted as an affirmative defense and we reassert, was jurisdictional. We appreciate no finding was made on this question by the trial judge, who otherwise determined the plaintiff had no case on the merits.

The complaint alleges that plaintiff is the owner of the patents issued to "co-workers" Faitelowitz, Volpertas and Rivoche, and also that plaintiff, by virtue of successive assignments is entitled to recover for past infringements of the three patents concerned. One of the issue litigated in the trial was the question of the legal succession of the plaintiff to the rights of the patentees, in the three patents concerned.

The records in the Patent Office disclose the following with respect to the chain of title in the Faitelowitz patent:

1. May 22, 1937, Faitelowitz assigned to Bunimovitch, prior to his applying therefor, 75% of his patent, recorded in the United States Patent Office June 3, 1957 (DX 16, II-25-26).

2. The Faitelowitz patent issued May 31, 1938, to Faitelowitz, recognized the assignment of the 75% interest to Bunimovitch.

3. May 27, 1940, Faitelowitz, at that time the owner of only 25% interest, assigned a 50% interest to Volpertas and Rivoche, recorded July 8, 1940. (DX 16, II-27, 28, 29)

4. October 20, 1943, title to the patent vested in the Alien Property Custodian (DX 16, II-32).

5. April 8, 1945, Volpertas and Rivoche assigned to Farmers' Marketing and Supply Company, Ltd., recorded December 21, 1949 (DX 16, II-40).

6. May 11, 1956, the Office of Alien Property, Department of Justice, assigned to Bunimovitch an undivided 75% of the patent (DX 16, II-42).

7. May 11, 1956, a similar assignment from the Office of Alien Property, Department of Justice, assigned to Volpertas and Rivoche an undivided 25% of said patent (DX 16, II-44).

8. July 30, 1956, Bunimovitch assigned to the Farmers' Marketing and Supply Company, Ltd., title to the patent (DX 16, II-50, 51).

This Assignment does not convey nor assign the right to sue for past infringements.

9. January 15, 1958, Farmers' Marketing and Supply Company, Ltd. assigns to Templeton Patents, Limited, its title to the patent, together with rights to recover for past infringements (DX 16, II-53-55, inclusive).

As noted above, Bunimovitch, a 75% owner of the patent involve[d] by assignment recorded August 3, 1956, transferred his interest in the patent, <u>without transferring the right to sue for infringements between the date of issuance of the patent, May 31, 1938, and the date of transfer.</u> It is basic that the right to sue for infringement follows the title to the patent. The plaintiff here claims a right to the patent as of the date of the alleged making of the contract in the summer of 1949, at which time Bunimovitch was one of the record owners of the patent. The Bunimovitch assignment to plaintiff was not made until the patent had expired by operation of law on May 31, 1955, and the record shows Bunimovitch was a co-owner of 75% of the patent until August 3, 1956.

In a much cited and leading decision, <u>Crown Die & Tool Co. v. Nye Tool & Machine Works</u>, 261 U.S. 24, 67 L. Ed. 516, the principle is laid down that infringement suits must be brought by the <u>owner</u> of legal title to the patent.

> "Both at law and in equity, either the owner of the patent at the time of the past infringement, or the subsequent owner of the patent, who is, at the same time, the assignee of the claims for past infringement, must be a party to a suit for damages for the past infringements."

See also: <u>Independent Wireless Telegraph Co. v. Radio Corporation of America</u>, 269 U.S. 459, 70 L. Ed. 357.

In <u>Switzer Brothers, Inc. v. Byrne</u>, 6 Cir., 242 F. 2d 909 (1957 it was determined that plaintiff's right to recover in a patent infringem

action would depend upon its title at the time of the inception of the action, and the failure to join several of the co-owners of the patent constituted a fatal defect.

> "As the alleged assignment was ineffective to transfer the title, the Switzer brothers and their wives, who were still tenants in common of an interest in the patents, had to be joined as parties. * * *. The conceded fact that appellant had the right to conduct and control litigation with reference to the patents is immaterial since it did not own the patents. * * *."

Hurd v. Sheffield Steel Corp., 8 Cir., 181 F. 2d 269 (1950) involved a patent infringement action which was dismissed for the reason that co-owners of the patent were not joined as indispensable parties plaintiff.

> "* * * It is well settled that where the patentee assigns an undivided part of the patent, action for infringement committed subsequent to the assignment must be brought in the joint name of the patentee and assignee as representing the entire interest. * * *.
>
> "Being of the view that all the co-owners of the patent must be joined as plaintiffs in a suit for infringement, the order of the court dismissing the action is affirmed."

It is settled, therefore, that in suits arising out of patents, they must be brought in the name of the patentee, or an assignee who has the exclusive right to the patent, and the right to enforce it. A simple assignment of a patent carries with it only the right to enforce that patent subsequent to the date of the assignment, and carries with it no right to sue for past infringements. In this action, the assignment by Bunimovitch of his 75% interest transferred only his rights in the

patent from thence on, and specifically omitted the right to sue for past infringements. Bunimovitch, or his heirs, are indispensable parties to this action.

IV. CONCLUSION

For the reasons herein set forth, counsel respectfully ask this court to affirm the Final Judgment made and entered by the District Judge, dismissing the complaint, with prejudice.

Respectfully submitted,

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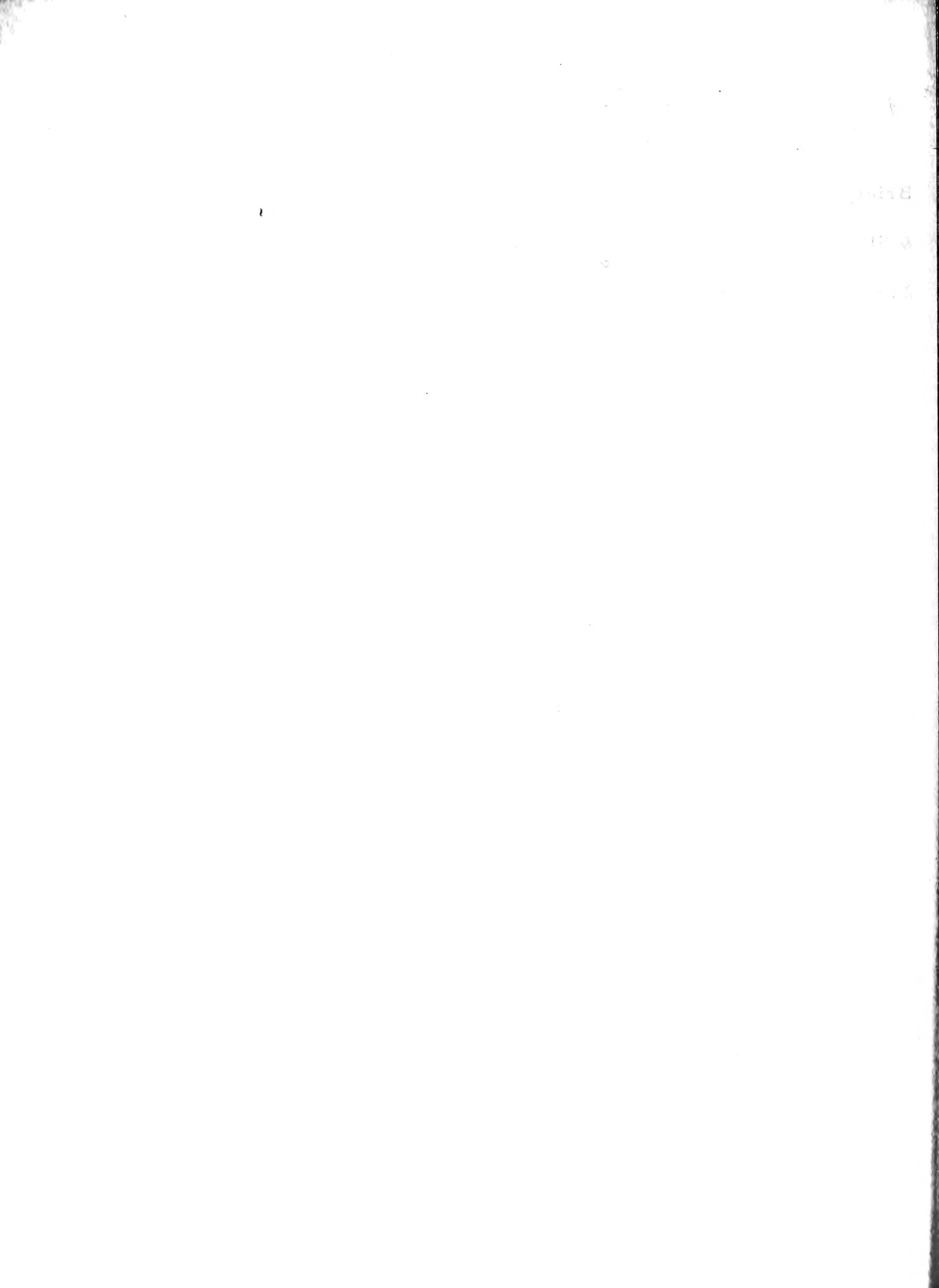
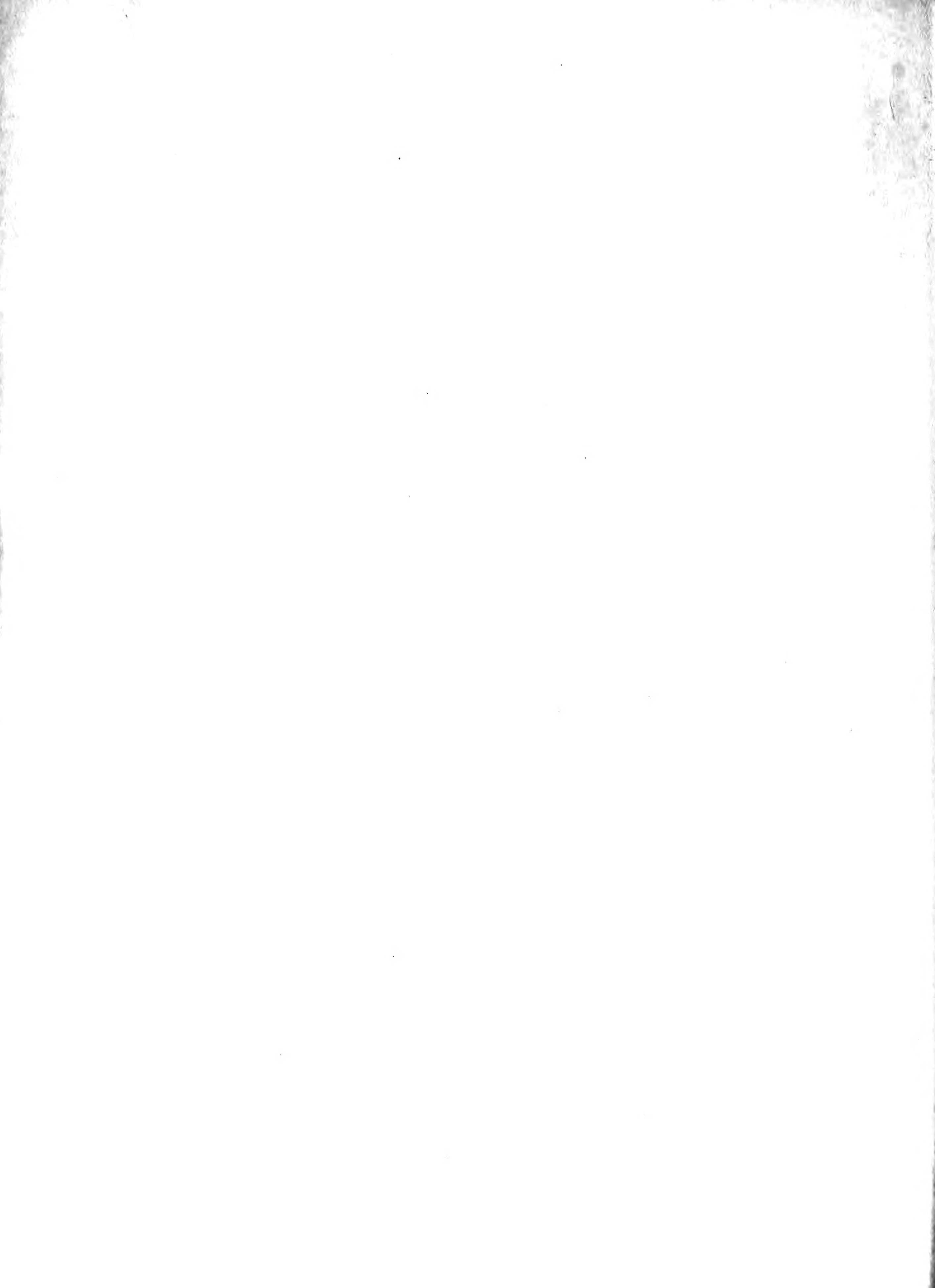
CERTIFICATE OF SERVICE

Counsel for appellant have been served with the foregoing Brief by delivery of ten copies to the offices of LANGROISE, CLARK & SULLIVAN, Suite 400, McCarty Building, Boise, Idaho, on the 23rd day of March, 1964.

JESS B. HAWLEY, JR.





A P P E N D I X

FINDINGS OF FACT

I.

This action was filed on February 1, 1960, seeking damages against the defendant for an alleged breach of contract, or in the alternative, for the accounting of the proceeds of an unjust enrichment. The plaintiff had previously filed an action on February 24, 1959, against the defendant, Docket Number 3514, charging defendant with having infringed three United States Patents owned by the plaintiff. By stipulation of the parties the two suits were consolidated for trial before the Court for the sole purpose of determining the question of defendant's liability, if any.

II.

Plaintiff is a British corporation engaged only in patent licensing and is owned principally by Robert A. S. Templeton and his wife. The former is the Chairman of the Board and its Managing Director. The defendant is a corporation organized and existing under and by virtue of the laws of the State of Nevada and has its principal place of business in the City of Boise, State of Idaho. This Court has jurisdiction under Section 1332, Title 28, U. S. C. A.

III.

Plaintiff is the owner of three United States Patents, each involving a process for making a dehydrated potato product, reconstitutable into a mashed potato dish. The patents involved are United States Patent No. 2, 119, 155 issued to Arnold Faitelowitz

and Marcos Bunimovitch on May 31, 1938, which patent expired May 31 1955; United States Patent No. 2,352,670 issued to Zelmanas Volpertas on July 4, 1944, which patent expired July 4, 1961; and United States Patent No. 2,520,891 issued to Farmers' Marketing & Supply Company (on an application by Eugene Joel Rivoche) on August 29, 1950, which patent expired September 16, 1959.

IV.

These processes were first introduced to Templeton by Rivoche in Great Britain in 1939. For several years Templeton had been interested in the vegetable drying industry and had made studies in Europe to determine if a successful process for manufacturing an instant mash potato powder had been discovered. Rivoche was the first to show him an acceptable product and to disclose a feasible process for making the same. A year later Templeton obtained exclusive licenses to the processes in question in behalf of Farmers' Marketing & Supply Company, plaintiff's predecessor. During World War II an instant mash potato drying industry arose in Great Britain based upon these same or similar processes.

V.

Meanwhile, in the United States the defendant was engaged in fruitless efforts to discover or obtain a successful process to fill the needs of our government. Defendant met with no success despite the fact that it had adequate facilities, finances, and skilled men in the art. Its expert witness, Ray W. Kueneman, had been employed by

the Department of Agriculture during World War II. He had visited dehydration plants abroad to gather information for our government, and had seen and made diagrams of plant operations in Great Britain which were using processes similar to the ones in suit. After the war the defendant employed his services, but for the next five years a successful process still eluded it. Templeton visited the United States in 1945 and became acquainted with defendant's efforts. Defendant's officers professed an interest in plaintiff's processes; however, at this time plaintiff had not perfected its rights thereto in this country.

VI.

Templeton returned to the United States in 1949 after having acquired to his satisfaction the exclusive rights to the Volpertas and the Rivoche processes wherever patented, and at that time made another trip to the State of Idaho in March, 1949, to confer with officials of the defendant company. Templeton wanted the defendant to take a license under the aforesaid patents, and in furtherance of this desire and because of the defendant's interest in the matter, Templeton, on March 4, 1949, conducted a laboratory demonstration at the defendant's plant in Caldwell, Idaho, during which he disclosed what he considered to be the basic teachings of the three patents involved. The record discloses that defendant was highly impressed by, and interested in, the processes. On March 8, 1949, Templeton submitted a written summary of what he considered to be the teachings

of the patents and a written recommendation to defendant based on the Faitelowitz process. The parties in March of 1949 orally arrived at a tentative and informal understanding in regard to developing a commercial process (and the industry) in the United States, which understanding was to be subsequently formalized. The broad and general understanding was expressly subject to and conditioned upon, the advice and approval of their respective legal counsel. The terms of the agreement were left to future negotiations, which, as events transpired, were very extended, with the parties ultimately failing to reach any agreement or meeting of minds. Before the parties reached any agreement the Korean War commenced and the defendant went into production to help fill the military requirements of the United States Government, and used some of the teachings of said patents in its own operations.

VII.

The testimony of the parties being in substantial conflict, and of necessity somewhat vague because of the lapse of time since the initial negotiations in 1949, the Court finds the most credible evidence concerning the dealings and negotiations between the parties looking to some contractual agreement is found in chronological order in the correspondence between them, Plaintiff's Exhibit No. 8. The Court finds from the evidence that the plaintiff has filed to sustain the burden of proof incumbent upon it to establish a contract existed between the parties.

VIII.

No express contract, either oral or in writing, was ever entered

into between the parties. The record shows only an indefinite and general understanding as to what their arrangements should be for the development and production of an instant mashed potato product for sale in the United States. Under the broad outline, plaintiff would grant defendant an exclusive license for the use of the Faitelowitz, Volpertas and Rivoche processes and would assist defendant in establishing its operation in exchange for a royalty based on production. Any agreement, however, was at all times subject to the approval of defendant's legal counsel, which, as events transpired, was never received, and thus prevented the parties from reaching a meeting of minds on the terms of an agreement.

Two main areas of conflict developed between the parties in their unsuccessful attempts to reach an agreement. The first involved the plaintiff's alleged ownership of the patents in question. The record shows that in April, 1949, plaintiff's predecessor acquired the Volpertas patent, and the Rivoche application owned by the plaintiff's predecessor was still pending. The Faitelowitz patent was and had been since 1943 the property of the Alien Property Custodian, and 75% of it had been assigned by Faitelowitz to one Marcos Bunimovitch in 1938. Plaintiff did not cure these defects in its title to the Faitelowitz patent until long after negotiations between the parties had terminated. Secondly, the defendant's patent counsel emphatically objected to the validity of the patents and though importuned by Templeton and his patent counsel to take a position otherwise, defendant's counsel remained adamant in his legal

position.

The first of the proposed formal agreements, in writing, was prepared by plaintiff's counsel and forwarded to the defendant on March 28, 1949. Defendant's counsel immediately raised the validity of the patents and the agreement was not signed. The parties, however, continued to negotiate on the assumption that the legal problems might be resolved, and Templeton encouraged the defendant to continue with its experiments. By October 12, 1949, the parties had reached no agreement, and at that time Templeton by letter advised the defendant that he would terminate negotiations unless the parties came to terms and at that time requested reimbursement of half of the traveling expenses and attorney's fees incurred. Defendant denied any obligation in connection with this reimbursement but did, however, forward on December 16, 1949, a proposed written agreement from its counsel substantially differing from the initial proposal of the plaintiff. This agreement went unsigned on advice of plaintiff's counsel. Thereafter, plaintiff sought to license other producers in the United States and appointed an agent in this country to negotiate with defendant and others in this respect.

Defendant went into full production in 1951, without there being at that time any agreement between the parties. Plaintiff had full knowledge of this, but took no action to prevent defendant's use of the proces in question nor to recover any compensation for technical information which it had furnished to the defendant. Plaintiff, instead, concentratec

on attempting to still obtain some form of a contract between the parties, and on August 18, 1951, proposed an agreement based solely on the Volpertas and Rivoche patents. Defendant would come to no terms on this. The last serious effort between the parties to negotiate some form of agreement occurred in June of 1952 at a conference between representatives of the parties, but likewise nothing came of this. Defendant continued to produce the instant mash potato powder and by 1954 had united with other producers in a joint defense against any legal action which might be taken against them. (Letter of May 4, 1954.) The plaintiff threatened such action, but none was forthcoming until in 1959 when its patent infringement action against the defendant was filed and this action was instituted a year later.

IX.

At no time did plaintiff make any demands on the defendant for the value of the technical services rendered by the plaintiff voluntarily, until this action was filed February 1, 1960. The Court believes that the plaintiff did supply the defendant with technical information of some benefit.

X.

The plaintiff, with full knowledge of the activities of the defendant, permitted the defendant to produce a dehydrated potato powder, using in part the principles of the patents involved, for a period of nine years before it instituted suit.

XI.

The Court finding that no express oral contract resulted from the negotiations of the parties, the cause of action for breach of contract accrued at the latest when the defendant went into production in 1951, and not as the plaintiff contends in 1956 when it received back from the Alien Property Custodian the Faitelowitz patent. The record further shows, without question, that by the year 1954 the defendant was openly and publicly critical of plaintiff's attempts to license other producers under the three patents involved and that such attitude was within the full knowledge of the plaintiff, the only conclusion to be reached being that defendant had no intention of reaching any agreement under which it would pay royalties to the plaintiff. Thus, if plaintiff was lulled into a sense of security as plaintiff contends, because of defendant's willingness to negotiate, which the Court does not find to be the fact, plaintiff's cause of action on any basis as set forth in its complaint would have accrued by 1954 at the very latest. The negotiations between the parties though extended over a long period of time, never assumed the status of a contract and not only did there exist no meeting of the minds, but the record in fact discloses the parties in complete discord on the very essence of any agreement, since the defendant at all times questioned the validity of the patents and the plaintiff's ownership thereof and the plaintiff at all times would under no conditions agree to the minimum royalty which defendant agreed it reluctantly would pay under all of the circumstances. That the negotiations continued for such an extended

period can be credited only to Templeton's perserverance and unwillingness to pursue any other remedies.

XII.

An action on an oral contract must be instituted within four years after the cause of action accrues. Section 5-217, Idaho Code. Plaintiff's action alleging an oral agreement between the parties therefore is barred under the Statute of Limitations. An agreement implied in law where benefits are conferred by one to another under circumstances which in equity and good conscience should not be retained without payment therefor likewise must be instituted within four years after such action accrues. Section 5-217, Idaho Code. Any action on the basis of an implied or quasi agreement between the parties having accrued in no event not later than the year 1954, such action likewise is barred by the Statute of Limitations above cited.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 18,903

FRED MEYER, INC., a corporation, and FRED G. MEYER and EARLE A. CHILES, individually and as officers of said corporation, *Petitioners,*

v.

FEDERAL TRADE COMMISSION, *Respondent.*

On Petition to Review and Set Aside Order of the Federal Trade Commission

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BRIEF FOR PETITIONERS

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 18,903

FRED MEYER, INC., a corporation, and FRED G. MEYER and EARLE A. CHILES, individually and as officers of said corporation, *Petitioners,*

v.

FEDERAL TRADE COMMISSION, *Respondent.*

On Petition to Review and Set Aside Order of the Federal Trade Commission

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BRIEF FOR PETITIONERS

STATEMENT OF JURISDICTION

This brief is filed on behalf of the petitioners, Fred Meyer, Inc. (hereinafter referred to as Fred Meyer), a corporation, and Fred G. Meyer and Earle A. Chiles, individuals,[1] to review and set aside an Order and Opinion of respondent Federal Trade Commission (hereinafter referred to as the Commission), issued on July 9, 1963 and

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[1] The individual petitioners, Fred G. Meyer and Earle A. Chiles, are Chairman of the Board and President, respectively, of Fred Meyer, Inc. Fred G. Meyer owns 38.35% and Earle A. Chiles 14.37% of the 1,479,250 shares of voting stock in Fred Meyer, Inc. (CX 363, pp. 3, 11).

served on petitioners on July 26, 1963 (R. 148-57).[2] The Order is based upon the Commission's two-count Complaint (R. 3-11) charging violations of section 2(f) of the Clayton Act, as amended (15 U.S.C. § 13(f)) and of section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. § 45). Petitioners filed their petition to review on September 17, 1963 (R. 707-14).

Jurisdiction of this Court is expressly provided by section 5(c) of the Federal Trade Commission Act, as amended (15 U.S.C. § 45(c)), and section 11(c) of the Clayton Act, as amended (15 U.S.C. § 21(c)), which authorize the filing, within sixty days from the date of service of a Commission order, of a petition to review in the Court of Appeals for any Circuit where the method of competition or act or practice in question occurred, or where the person or corporation against whom the order is issued resides or carries on business. The acts and practices involved in this proceeding occurred in Portland, Oregon, within this Court's jurisdiction, and petitioners reside and carry on business within the jurisdiction of this Court, the principal office and place of business of Fred Meyer being located at 721 Southwest Fourth Avenue, Portland, Oregon (R. 3, 12).

STATEMENT OF THE CASE

A. HISTORY OF THE PROCEEDING

Fred Meyer is an Oregon corporation operating thirteen retail grocery supermarkets in the Portland, Oregon area (R. 27, 60, 164-5). Its net sales exceed $40 million annually (CX 363, p. 4).[3]

For approximately twenty-five years, during a four-week period beginning in September and ending in October, Fred Meyer has conducted an annual promotion called the "coupon book promotion" (R. 62, 166; CX 1, 4, 24) which consisted of the offering to consumers by Fred Meyer of

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[2] The abbreviation "R." refers to the Transcript of Record printed and filed in accordance with the rules of this Court.

[3] The abbreviation "CX" refers to Commission Exhibit.

special prices and terms of sale on certain featured products through the medium of coupon books. In conjunction with and as part of the promotion, Fred Meyer specially promoted the featured products through various and numerous advertising and merchandising media. Prior to each promotion, coupon books were printed and distributed to consumers. The books contained seventy-two coupon pages, each relating to a different item. On redemption of these coupons, consumers received various benefits, such as free or sample items, and reduced prices on multiple purchases (R. 29).

To finance the coupon book promotions, Fred Meyer invited the participation of its suppliers. Suppliers agreeing to participate received a page in the coupon book advertising the particular product chosen to be featured, plus numerous promotional services and facilities furnished and conducted by Fred Meyer designed to promote the featured products during the period of the promotion. Suppliers participated under terms agreed upon prior to the promotion (R. 167, 169-70, 181). Some, for example, granted allowances related to the volume of goods purchased by Fred Meyer for resale during the promotion, paid flat sum promotional allowances, or redeemed coupons submitted by consumers.

All payments received from and made by the participating suppliers were designed and contemplated to constitute reimbursement to Fred Meyer for the furnishing of promotional services and facilities, consisting, at a minimum, of the printing of coupon books, preparation and dissemination of sales bulletins to Fred Meyer's sales personnel, conducting of sales meetings and sales contests to inform and offer incentive to Fred Meyer's sales personnel, preparation and construction of window displays, in-store displays, signs and banners, and conducting of newspaper and radio advertising (CX 6, 13, 18, 19, 200, 201; R. 428-30, 692).

At various times, Fred Meyer has also conducted promotional programs unrelated to the coupon book promotion, and, in some instances, received promotional allow-

ances from certain of its suppliers in connection with such promotions (R. 75-76).

On May 15, 1959, the Commission issued a two-count complaint against petitioners (R. 3-11). Count I of the complaint charged that petitioners violated section 2(f) of the Clayton Act, as amended (15 U.S.C. § 13(f)),[4] by inducing and receiving "discriminatory prices, discounts, allowances, rebates and terms and conditions of sale" from suppliers which they knew or should have known were granted by such suppliers in violation of section 2(a) of that Act (15 U.S.C. § 13(a)).[5] Said discriminatory prices were allegedly granted by suppliers in connection with the coupon book promotion described above.

Count II of the complaint charged that petitioners violated section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. § 45),[6] which prohibits unfair "acts or practices in commerce," by inducing and receiving payments from certain suppliers in consideration for the fur-

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[4] Section 2(f) of the Clayton Act provides:

> That it shall be unlawful for any person engaged in commerce, in the course of such commerce, knowingly to induce or receive a discrimination in price which is prohibited by this section.

[5] Section 2(a) of the Clayton Act provides in pertinent part:

> That it shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them: *Provided,* That nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered.

[6] Section 5 of the Federal Trade Commission Act provides in pertinent part:

> Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful.

nishing of promotional services or facilities which petitioner knew or should have known were granted in violation of section 2(d) of the Clayton Act, as amended (15 U.S.C. § 13(d)).[7] The allegations contained in Count II of the complaint primarily concern petitioners' annual coupon book promotion. The Commission also challenged, under Count II, certain promotional allowances paid to Fred Meyer which were unrelated to the coupon book promotion. Petitioners denied the allegations of illegality under both Count I and Count II (R. 12-17).

On January 23, 1962, after administrative hearings, an initial decision was filed by a Hearing Examiner finding violations as charged (R. 18-54). Petitioners appealed to the Commission and, on March 29, 1963, a three-member majority of the Commission affirmed the Examiner and issued a proposed order to cease and desist (R. 56-142).[8] Exceptions to the proposed order were rejected and, on July 9, 1963, the proposed order was adopted by the Commission as its final order (R. 148-57).

B. DESCRIPTION OF THE ALLEGEDLY UNLAWFUL TRANSACTIONS

The allegedly unlawful transactions involved in this case relate to the receipt of certain payments granted by five suppliers of Fred Meyer: Tri-Valley Packing Association, Idaho Canning Company, Cannon Mills Company, Burlington Industries, Inc., and Philip Morris Company. All of the challenged transactions, except those involving

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[7] Section 2(d) of the Clayton Act provides:

> That it shall be unlawful for any person engaged in commerce to pay or contract for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale, or offering for sale of any products or commodities manufactured, sold, or offered for sale by such person, unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities.

[8] One member of the Commission dissented in part to the action of the majority and one Commissioner did not participate (R. 142).

Philip Morris, relate to payments received by Fred Meyer in connection with its 1956, 1957 or 1958 coupon book promotions.

Thus, Tri-Valley Packing Association is alleged to have favored Fred Meyer in terms of sale and promotional benefits over Hudson House, a wholesaler, in connection with the 1957 coupon book promotion; Idaho Canning Company is alleged to have favored Fred Meyer in the same manner as against Hudson House and Wadhams & Company, also a wholesaler, in connection with the 1957 coupon book promotion; Cannon Mills Company allegedly favored Fred Meyer as compared to Roberts Brothers, a retailer, in connection with the 1956 coupon book promotion; and Burlington Industries, Inc. allegedly favored Fred Meyer over Lipman, Wolfe & Company, a retailer, in connection with the 1957 and 1958 coupon book promotions. These challenged coupon book transactions are summarized in the following table:

Year	*Supplier*	*Product Sold To Fred Meyer*	*Allegedly Disfavored Customer*	*Date of Agreement On Terms*	*Date of Coupon Promotion*
1. 1957	Burlington Industries, Inc.	"Rose Dawn" nylon hose (private brand)	Lipman, Wolfe & Co., (retailer)	March, 1957 (R. 427)	Sept.-Oct., 1957 (CX 4, p. 34)
1958	Same	Same	Same	March, 1958 (R. 433-34)	Sept.-Oct., 1958 (CX 24, p. 34)
2. 1956	Cannon Mills, Inc.	Fingertip Towels	Roberts Bros. (retailer)	March, 1956 (CX 119-22; R. 359-60)	Sept.-Oct., 1956 (CX 1, p. 37)
3. 1957	Idaho Canning Company	"My-Te-Fine" whole kernel or cream style corn (private brand)	Hudson House (wholesaler) Wadhams & Co. (wholesaler)	Spring, 1957 (R. 208)	Sept.-Oct., 1957 (CX 4, p. 61)
4. 1957	Tri-Valley Packing Association	"My-Te-Fine" yellow cling sliced or halved peaches (private brand)	Hudson House (wholesaler)	Spring, 1957 (R. 193-94, 553, 587)	Sept.-Oct., 1957 (CX 4, p. 60)

In addition to the foregoing, the Commission also alleged, under Count II of the complaint, that the acceptance by Fred Meyer of certain payments unrelated to the coupon book promotions from Philip Morris Company violated section 5 of the Federal Trade Commission Act. The customers of Philip Morris which are alleged to have been discriminated against in terms of promotional benefits are Oregon Piggly Wiggly Company, a retail grocery chain, and United Grocers, Inc., a wholesaler-cooperative. It is not charged that Philip Morris granted price discriminations in violation of section 2(a), or that Fred Meyer received price discriminations from Philip Morris in violation of section 2(f).

SPECIFICATION OF ERRORS

1. The Commission erred as a matter of fact[8a] and of law in holding that the payments received by Fred Meyer from its suppliers for the coupon book promotions are cognizable under sections 2(a) and 2(f) of the Clayton Act. These payments are cognizable, if at all, only under section 2(d) of the Clayton Act and section 5 of the Federal Trade Commission Act.

2. The Commission erred as a matter of fact and of law in holding that section 2(d) of the Clayton Act requires a seller who offers or grants payments for services or facilities to its *retail* customers to offer proportionally equal payments to its *wholesale* customers.

3. The Commission erred as a matter of fact and of law in holding that the payments by the suppliers herein involved violated either section 2(a) or section 2(d) of the Clayton Act.

4. The Commission erred as a matter of fact and of law in holding that petitioners knew or had reason to know that the prices or allowances received from suppliers were

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8a None of the conclusory findings of violation are supported by reliable, substantial and probative evidence as required by the Administrative Procedure Act. *Universal Camera Corp.* v. *NLRB,* 340 U.S. 474 (1951).

granted in violation of section 2(a) or section 2(d) of the Clayton Act.

5. The Commission erred as a matter of law in holding that it is authorized to proceed against a buyer under section 5 of the Federal Trade Commission Act for the alleged inducement of payments in consideration for the furnishing of services and facilities alleged to have been granted in violation of section 2(d) of the Clayton Act.

6. The Commission erred in issuing an order to cease and desist against the individual petitioners since special circumstances presenting a likelihood that the corporate petitioner will evade or attempt to evade the order are absent.

7. The Commission erred in failing to frame its order to cease and desist in terms which bear a reasonable relationship to the practices alleged to be unlawful.

SUMMARY OF ARGUMENT

I. The Payments Received From Suppliers In Connection With The Coupon Book Promotions Are Not Cognizable Under Section 2(a) or 2(f) Of The Clayton Act

Misconstruing the evidence, the Commission has concluded that all the suppliers which participated in the coupon book promotions made payments to Fred Meyer of $350; that only these payments were made in consideration for the furnishing of services and facilities rendered by or through Fred Meyer and, therefore, were the only payments which constituted true promotional allowances within the meaning of section 2(d); and that amounts paid in excess of $350 were necessarily price concessions cognizable under the section 2(a)-2(f) charge of the complaint. These findings are erroneous.

The terms of participation in, and the payments received by Fred Meyer for, the coupon book promotions resulted from agreements entered into between Fred Meyer and each participating supplier which contemplated that the payments were in consideration for services and facilities rendered by Fred Meyer in conducting the promotion and featuring the agreed upon products of each supplier.

Thus, each payment was made, in the language of section 2(d), "as compensation or in consideration for . . . services or facilities furnished by or through" Fred Meyer "in connection with the processing, handling, sale or offering for sale" of the products of each supplier. While price concessions, to fall within the purview of section 2(a), must be intended to induce the *original sale,* promotional payments under 2(d) relate only to the *resale.* The Commission erroneously and arbitrarily attempted to segregate certain portions of each supplier's payment and construe one portion as a price concession and another as a true promotional allowance. This cannot be done.

Moreover, the evidence is that less than half of the suppliers actually made payments of any flat sum, such as $350. Where such a flat sum payment was made, it was in consideration for only one of the five separate and distinct services and facilities which were performed by Fred Meyer in connection with the coupon book promotion, *viz.,* preparation and printing of the coupon books. The remainder of the payments by suppliers which did grant flat sum allowances were in consideration for the other and substantial services and facilities rendered. Since it is clear that each supplier intended that its payment be promotional in nature, there can be no finding that any portion of any supplier's payment actually constituted a price concession rather than a true promotional allowance absent specific and exact proof that services and facilities were not in fact rendered by Fred Meyer in accordance with the understanding of the parties.

As a matter of law, the cost of the services and facilities rendered by Fred Meyer are not required to equal the dollar payments made in consideration of such services and facilities. *Lever Brothers Co.,* 50 F.T.C. 494 (1953). For example, the value to a seller of a mass aisle-end display in petitioners' stores cannot be measured with any degree of precision. Moreover, even as to direct and indirect expenses incurred by Fred Meyer which could be measured, no evidence was adduced. The Commission, therefore, erred in entering an order to cease and desist under Count I of the complaint (see *infra,* pp. 16-26).

II. Section 2(d) Does Not Require A Seller Who Offers or Grants Promotional Allowances to a Retail Customer to Offer Comparable Benefits to Wholesale Customers

It is long-standing precedent that a seller who offers or grants payments as compensation for the furnishing of promotional services or facilities to one or more of its *retail* customers is *not* required to offer proportionally equal benefits to its *wholesale* customers. The Commission, however, now attempts to reverse this precedent and, in reinterpreting the statute, has held that *wholesalers* must be offered benefits comparable to those offered or granted *retailers*. Such a novel re-interpretation of the statute, if approved, would revolutionize present distributional patterns and practices in many industries. Moreover, such an interpretation ignores entirely the fact that Congress, in section 2(d), did not expand the applicable concept of competition as it did in 2(a). Finally, the Commission's holding is directly contrary to this Court's holding in *Tri-Valley Packing Association* v. *Federal Trade Commission,* 329 F.2d 694, 707 (9th Cir. 1964) (see *infra,* pp. 26-37).

III. The Commission Failed to Prove that Payments by Any of the Suppliers Involved Violated Section 2(a) or 2(d)

In proceedings under sections 2(a) and 2(d), the Commission is required to prove, *inter alia,* that the allegedly favored and disfavored customers (1) purchased goods of like grade and quality (2) at or about the same time and that, (3) at the time in question, these customers actually and effectively competed in the resale of such products. However, the fragmentary evidence adduced by the Commission fails entirely to establish that the products which Fred Meyer purchased for resale during the coupon book promotions, and which were featured under agreement with participating suppliers, were purchased, handled, or sold by the allegedly disfavored customers, or that products which were purchased by such customers were of like grade and quality within the meaning of the statute to those purchased and featured by Fred Meyer.

The Commission also failed to adduce evidence sufficient to establish that the allegedly disfavored customers purchased products of like grade and quality from the suppliers involved at or about the same time as did Fred Meyer.

The nature of Fred Meyer's coupon book promotion rendered it essential that all arrangements be concluded well in advance of the promotion itself, which was conducted during a four-week period in September and October. Negotiations for the promotion were commenced in January or February of each year and agreements as to prices, allowances and other terms of sale were reached in the spring of each year. There is no evidence, however, which shows the prices, allowances, or other terms of sale which were in fact offered or available to the allegedly disfavored customers at the time the actual agreements were reached.

Nor has the Commission established that the allegedly disfavored customers actually competed with Fred Meyer in the resale and distribution of the relevant products. As noted previously, three of the allegedly disfavored customers, Wadhams & Co., Hudson House and United Grocers, insofar as the transactions in this case are concerned, operated solely as wholesalers. Under this Court's *Tri-Valley* decision, *supra,* wholesale customers do not compete with retail customers within the meaning of section 2(d) and it was essential to a finding of violation of that section that the Commission prove (1) actual competition between the retail customers of such wholesalers and Fred Meyer and (2) that such retail customers of the wholesalers were actually "indirect" customers of the suppliers charged to have violated section 2(d). However, in no instance did the Commission attempt to establish the required "indirect" customer relationships or successfully trace the relevant products to the shelves of the retail customers of such wholesalers.

The Commission's failure to adduce reliable probative and substantial evidence sufficient to prove the above essential elements of the alleged supplier violations requires

dismissal of both Count I and Count II of the complaint (see *infra*, pp. 37-66).

IV. Fred Meyer Neither Knew Nor Had Reason to Know that the Prices and Payments Received from Suppliers Were Unlawful

Section 2(f) of the Clayton Act makes it illegal for a buyer to induce or receive discriminations in price when the buyer knows or has reason to know that such prices are prohibited by section 2(a) of the statute. In addition, it has been held that the Commission may proceed under section 5 of the Federal Trade Commission Act against a buyer who has induced a seller to grant a promotional payment or allowance which the buyer knows or has reason to know is unlawful under section 2(d) of the Act.[9]

The Commission has attempted to overturn the Supreme Court's holding in *Automatic Canteen Co.* v. *Federal Trade Commission,* 346 U.S. 61 (1953). That case sets forth the applicable tests for cases which involve the alleged inducement of discriminatory prices. Thus, the Commission failed to find that Fred Meyer "knowing full well that there was little likelihood of a defense for the seller, nevertheless proceeded to exert pressure for lower prices" (*Id.* at 79). There is no evidence that Fred Meyer exerted any "pressure" upon sellers to participate in the coupon book promotion.

Secondly, the Commission totally disregarded the requirement that, under section 2(f), it must be shown that the buyer knew the seller could not justify its prices. In *Automatic Canteen,* the Supreme Court declared that an inference of "guilty knowledge" could not properly be drawn unless the allegedly favored and disfavored buyers purchased in substantially the same quantities and were served in the same manner and with the same amount of exertion. Here, however, the Commission failed to find that the quantities were substantially the same or that the manner of service and the amount of exertion on the

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[9] Petitioners contend that these holdings are in error (see *infra*, pp. 91-94).

seller's part were the same. To the contrary, the record conclusively demonstrates that Fred Meyer purchased unusually large quantities in connection with the coupon book promotion. Moreover, the Commission has failed to establish that the manner of service and the amount of exertion on the seller's part in obtaining orders for goods to be used in the coupon book promotion and in obtaining orders from allegedly disfavored customers were similar. Instead, the Commission merely infers that Fred Meyer is "unable" to get price concessions from its suppliers during eleven months of the year and, based upon this inference, further infers that the purchase of an extremely large quantity of products for the coupon book promotion could not give rise to measurable cost savings. This inference, based upon nothing more substantial than speculation, is completely contrary to the evidence.

It was incumbent upon the Commission to establish that Fred Meyer's suppliers incurred no cost savings and that Fred Meyer knew or should have known this fact. That this essential element of proof cannot be inferred and that the Commission erred in so inferring is eloquently demonstrated by reference to the price concessions granted by Cannon Mills. The Commission has found that these concessions were received by Fred Meyer with "knowledge" of illegality. No evidence was adduced by the Commission as to the possible cost justification of Cannon Mills' prices. However, in a proceeding against Cannon Mills itself for the granting of the very prices Fred Meyer has been found to have induced unlawfully, Cannon Mills successfully proved that such prices were cost justified. *Cannon Mills Co.*, Docket 7494, Initial Decision (Dec. 3, 1963). Indeed, the Examiner found that Cannon Mills' cost savings were even greater than required to justify the price concessions to Fred Meyer.

It is clear, therefore, that the Commission has drawn improper inferences and ignored substantial evidence concerning the nature of the questioned transactions and the mode of doing business in the retail grocery industry which would lead a reasonable man to believe that the

prices received by Fred Meyer could be cost justified by its suppliers (see *infra,* pp. 66-79).

The so-called proof relied upon by the Commission in an effort to establish that the promotional allowances received by Fred Meyer were known to be in violation of section 2(d) is equally defective (see *infra,* pp. 79-90).

V. The Commission is not Authorized to Proceed Against a Buyer for the Alleged Inducement of Disproportionate Promotional Payments Under Section 5 of the Federal Trade Commission Act

Section 5 of the Federal Trade Commission Act prohibits "unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce." While the Commission has held that section 5 authorizes it to proceed against a buyer for the alleged inducement of disproportionate promotional payments, and while this interpretation of this statute has been sustained, over strong dissent, by two Circuit Courts of Appeal [10] the issue has not yet been finally determined.

It is petitioners' position that the dissenting views which have been expressed accurately state the law and must prevail. Thus, while section 2(f) prohibits buyers from inducing discriminations in price which are prohibited by 2(a), and while section 2(c) prohibits buyers from inducing illegal brokerage allowances, a prohibition against the inducement of allegedly discriminatory promotional allowances was "studiously omitted" from the statute. The Commission's effort to supply, through interpretation, a legislative "oversight" is contrary to applicable standards of statutory construction and cannot stand (see *infra,* pp. 91-94).

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[10] *Grand Union Co.* v. *Federal Trade Commission,* 300 F.2d 92 (2d Cir. 1962); *American News Co.* v. *Federal Trade Commission,* 300 F.2d 104 (2d Cir. 1962), *cert. denied,* 371 U.S. 824 (1962); *Giant Food Inc.* v. *Federal Trade Commission,* 307 F.2d 184 (D.C. Cir. 1962), *cert. denied,* 372 U.S. 910 (1963).

VI. The Commission Erred in Issuing an Order to Cease and Desist Against the Individual Petitioners

Orders to cease and desist against officers of a corporation in their individual capacity are proper only where "special circumstances" exist which indicate a likelihood of evasion of the order by the corporation. Such "special circumstances" are absent in the present case. If any order to cease and desist is proper in the present case, it can only be directed against the corporation and its officers, representatives, agents and employees in their corporate capacity, not in their individual capacity (see *infra,* pp. 95-96).

VII. The Commission Erred in Issuing an Order Which Bears No Reasonable Relation to the Acts and Practices Alleged to be Unlawful

Existing precedent makes it clear that Commission orders must be framed in terms bearing a reasonable relationship to the practice alleged to be in violation of the law. In the present case, however, the Commission has entered a broad, all-encompassing order to cease and desist which covers all acts and practices cognizable under the statute. This is true of the orders issued under both Counts I and II. If any order to cease and desist is proper, it must be directed solely against the allegedly illegal aspects of the coupon book promotion and must clearly advise petitioners of the acts or practices which are to be discontinued (see *infra,* pp. 96-102).

ARGUMENT

I. INTRODUCTION

The ultimate issue presented here is whether petitioners induced unlawful prices and promotional payments from suppliers with knowledge or reason to believe that such prices and allowances were granted in violation of the law. As a prerequisite to a finding that petitioners violated the law, it must first be established that the specified suppliers violated section 2(a) or 2(d), or both. However, before reaching the question of whether each of the specified sup-

pliers violated section 2(a) or section 2(d), or both, or whether Fred Meyer knew or should have known this, there are two threshold questions which, if decided favorably to petitioners, will narrow substantially the scope of the case. These threshold questions are:

1. Were the payments received by Fred Meyer from suppliers in connection with the coupon book promotion cognizable under section 2(f) of the Clayton Act? If not, as petitioner here urges, then Count I falls and the Court need only concern itself with Count II.

2. Does section 2(d) of the Clayton Act, involved in Count II, require a seller who offers or grants promotional benefits to a *retail* customer to offer proportionally equal benefits to *wholesale* customers who operate at a different functional level? If, as petitioner here urges, a seller is not required to make proportional offers to such wholesale customers, then all of the Count II evidence in this case respecting two of the five suppliers, and part of the evidence respecting a third supplier, can be totally disregarded, thus narrowing substantially the scope of the case.[11]

II. THRESHOLD QUESTION NO. 1: ARE THE PAYMENTS RECEIVED FROM SUPPLIERS IN CONNECTION WITH THE COUPON BOOK PROMOTIONS COGNIZABLE UNDER SECTIONS 2(a) AND 2(f) OF THE CLAYTON ACT

Petitioners submit that the payments received from suppliers in connection with the coupon book promotions are not cognizable, as alleged in Count I, under sections 2(a) and 2(f) of the Clayton Act. These payments were true promotional allowances within the meaning of section 2(d) of the Act, and their alleged inducement is cognizable, if at all, only under section 5 of the Federal Trade Commission Act. This conclusion is compelled by the fact that (1) the coupon book promotion was an institutional pro-

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[11] The two suppliers regarding which all evidence can be disregarded are Idaho Canning Company and Tri-Valley Packing Association. The allegedly disfavored customers of these suppliers are the wholesalers, Wadhams & Co. and Hudson House. Likewise, the evidence relating to Philip Morris Company's dealings with United Grocers, Inc., also a wholesaler, can be disregarded.

motion involving a combination of advertising and promotional services furnished by or through Fred Meyer "in connection with the processing, handling, sale or offering for sale" of the individual supplier's products, and (2) the payment of each supplier was made pursuant to agreement with Fred Meyer which contemplated, and was tied directly to, the furnishing of promotional services and facilities by Fred Meyer in connection with the resale of the products of the participating suppliers.

Section 2(a) of the Clayton Act deals with and prohibits discriminations in "price" under certain specified conditions. Section 2(d), on the other hand, deals with and prohibits, under certain specified conditions, "the payment of anything of value to or for the benefit of a customer . . . as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale or offering for sale" of a seller's products.

Thus, the ultimate legal question here involved is whether participation in the Fred Meyer coupon promotion resulted in the sale of commodities to Fred Meyer at a "price" reduction or whether the result was the "payment" to Fred Meyer of "anything of value . . . as compensation or consideration for any services or facilities furnished by or through" Fred Meyer "in connection with the processing, handling, sale or offering for sale" of the products of the participating suppliers.

"Price," as stated by the FTC's Advisory Committee on Cost Justification, "is measured by the value of the consideration which passes from buyer to seller" and is "net of all applicable allowances, discounts and rebates which the buyer receives or is entitled to receive in view of the quantities and methods of his purchases." Rowe, *Price Discrimination Under the Robinson-Patman Act* (1962), p. 92. Thus, "price" is regarded as the net consideration which induces the *original sale,* as distinguished from consideration flowing from factors other than inducement of the striking of the deal as such between buyer and seller. Rowe, *supra,* at 379. The "mere acceptance by a pur-

chaser of a promotional offer intended to facilitate the *original sale,* does not constitute the rendering of a service or facility by the purchaser within the meaning of Section 2(d).'' *New England Confectionery Co.,* 46 F.T.C. 1041, 1059 (1949) (emphasis added); Rowe, *Ibid.* On the other hand, where the consideration passing between buyer and seller is in some way tied to the *resale,* as distinguished from *original sale,* the net consideration passing between buyer and seller is not, within the meaning of section 2(a), an element of ''price''. Rather, it is a "payment" for ''services or facilities furnished'' by the customer ''in connection with the processing, handling, sale or offering for sale'' of said products. As stated by Rowe: "As a rule of thumb, sections 2(e) and 2(d) will govern the supplier's provision of any form of *cooperative* advertising or promotional expenditures or services in connection with the customer's *resale* of the product'' Rowe, *supra,* at 372 (emphasis in original). Thus, if the consideration rests upon factors other than normal price negotiations between buyer and seller to effectuate the *original sale,* the transaction falls within section 2(d). *Tri-Valley Packing Association* v. *Federal Trade Commission,* 329 F. 2d 694, 708 (9th Cir. 1964). "Price'', as negotiated in connection with an original sale, has no strings attached and is not dependent upon the ''resale'' functions and activities of the purchaser.

Consistent with the foregoing clear understanding of the relationship of the two sections, the courts have held, for example, that a consideration passing between buyer and seller in connection with freight and delivery arrangements is not within section 2(d), but is cognizable, if at all, under section 2(a) as an element of ''price''. *American Can Co.* v. *Russellville Canning Co.,* 191 F.2d 38, 56 (8th Cir. 1951). Likewise, consideration passing between buyer and seller as the result of credit arrangements does not fall within the definition of services or facilities, but rather are elements of ''price''. *Skinner* v. *United States Steel Corp.,* 233 F.2d 762, 765 (5th Cir. 1956). Obviously, such elements of con-

sideration relate to the original sale, not to resale. On the other hand, it is well settled that where money or something of value is granted by a seller to a buyer with the intention that the buyer render advertising or promotional services or facilities, there is a payment "as compensation or in consideration" for such services, and the transaction is cognizable, if at all, under section 2(d). *Tri-Valley Packing Association* v. *Federal Trade Commission, supra,* at 708; *Yakima Fruit & Cold Storage Co.,* 59 F.T.C. 693 (1961). Section 2(d) is inapplicable only if the payment granted "does not have any connection with" the customer's resale. *Skinner* v. *United States Steel Corp., supra* at 765; Rowe, *supra,* at 383.

There is no question that the Fred Meyer coupon book promotion involved an integrated and comprehensive cooperative program of advertising and promotional services conducted "by or through" Fred Meyer "in connection with the processing, handling, sale or offering for sale" of the individual supplier's products. Contrary to the situation where a "price" is negotiated to facilitate the "original sale," the payments received by Fred Meyer were tied to and totally dependent upon the "resale" activities of Fred Meyer. Fred Meyer was not free, under the agreements reached with the suppliers, to pay for the goods, receive the promotional allowances agreed upon and then "go its own way." It was obligated to offer the goods for resale during the period of the promotion and was further obligated, in order to promote the resale of such goods, to print, and distribute to consumers, coupon books containing graphic advertisement of the featured products, specially promote such products through in-store displays and broadcasts, prepare and utilize point-of-sale materials, specially display at point-of-sale the pertinent coupon page advertisements, redeem and tabulate the coupons in accordance with agreed upon terms, conduct special newspaper and radio advertising, and conduct a host of other related activities, all in connection with the resale of the commodities involved (CX 6, 13, 18, 19, 200, 201).

It being the intention of the parties as to the use and nature of a payment or concession which controls the issue of whether that payment constitutes a promotional allowance or a price concession, it is obvious that the coupon book transactions challenged here fall only within the purview of section 2(d). The Commission, however, arbitrarily segregated portions of each supplier's payment and held that only the first $350 of each payment constituted a true promotional allowance. The amount of each supplier's payment in excess of $350, held the Commission, was "of an entirely different character" and constituted an "outright price concession" in that such amounts were in no way connected with promotional services or facilities furnished by Fred Meyer or with the resale by Fred Meyer of the featured products (R. 70). In view of the commitments made by Fred Meyer to induce participation by suppliers, and in view of the uncontradicted evidence that Fred Meyer did in fact furnish numerous and substantial services and facilities, this conclusion of the Commission is incomprehensible.

Suppliers who participated in the coupon book promotion were promised and received, *at a minimum,* the following services or facilities (CX 6, 18, 19):

1. *Printing and Distribution of Coupon Books.* Coupon books containing approximately 72 coupons, each featuring a different item, were printed by Fred Meyer and sold to Fred Meyer's customers at 10¢ per book (R. 64). The coupon pages usually contained a graphic representation of each item, a statement of its "regular" price, a statement of the "coupon" price, a statement of the amount in dollars and cents of what the coupon was "worth" in savings to the consumer, and similar statements common in advertising material (R. 62-63).

2. *Sales Bulletins and Meetings.* Sales bulletins were disseminated to Fred Meyer's sales clerks. Sales meetings were held and sales contests were conducted. The purpose of these activities was to keep Fred Meyer's sales clerks fully informed concerning the selling points of the

featured products and to direct their efforts in promoting the products of participating suppliers (CX 6, 8, 19).

3. *In-Store Displays, Banners and Broadcasting.* Window and in-store displays, signs, banners and in-store broadcasting were prepared and furnished during the coupon book promotions. Thus, for example, Fred Meyer was obligated to prepare "a feature display sign in our stores containing your coupon. . ." (CX 6).

4. *Newspaper Advertising.* Newspaper advertising featuring the products of participating suppliers was conducted. Such advertisements appeared almost daily in the Oregon Journal, The Oregonian, the Eugene Register Guard and other newspapers during the period of the coupon book promotion (CX 6).

5. *Radio Advertising.* Radio advertising featuring the products of participating suppliers was conducted on the "Fred Meyer Consumer News," a news program transmitted daily by radio station KOIN, Portland, Oregon. The coupon book items were also advertised on "Fred Meyer Dance Time," a two-hour musical program, and "spot" advertisements were placed on a number of radio stations, including stations KWJJ, KXL, KPOJ, KEX and KGW (CX 6, 18, 19).

Direct expenses alone incurred by Fred Meyer in furnishing the above services and facilities, plus others, in connection with the coupon book promotions were as follows:

Service or Facility	1956 (CX 13)	1957 (CX 200)	1958 (CX 201)
Newspaper Advertising	$7,622	$7,911	$7,474
Art Work, Engraving, etc.	655	64	64
Other Production Costs	1,246	—	—
Printing Books	9,845	9,845	10,734
Payroll (Counting Coupons)	1,525	1,515	1,545
Radio Spots	1,020	391	1,020
Prizes for Selling Books	934	1,081	—
Printed Signs	256	599	1,151
Handmade Signs	205	244	201
Freight Paid on Free Merchandise	—	1,756	—
Hauling	—	—	11
	23,318	23,406	22,200

In addition, Fred Meyer incurred substantial indirect expenses, including general overhead, merchandisers' and buyers' time, travel expenses, accounting expenses, employees' time in erecting and maintaining special in-store displays over a 4-week period, etc. (CX 6, 13, 18, 19, 200, 201). The Commission, however, failed to adduce evidence as to the amount of such expenses.

Moreover, while the Commission inferred that each of the 72 participating suppliers paid $350 for a coupon book page (R. 64-65), the actual evidence is that fewer than 30 of the 72 participating suppliers paid such an amount (or any other flat sum) toward the cost of the coupon book itself (CX 2 A-C, 5 A-B, 23 A-C). Thus, during the years in question, 1957, 1958 and 1959, the amounts actually paid by suppliers toward the cost of the coupon book were substantially less than that found by the Commission. In 1956, 27 suppliers made payments for coupon book pages ranging from $150 to $625 for a total of $9,385 (CX 2 A-C). In 1957, 24 suppliers made such payments ranging from $250 to $350 for a total of $8,100 (CX 5 A-B). In 1958, 26 suppliers made payments ranging from $175 to $350 for this purpose, the total amounting to $8,365 (CX 23 A-B).[12]

In the case of suppliers who paid a flat sum in cash or in kind as all or part of the payment toward the coupon book promotion, the amount paid was in reimbursement only of ". . . all art work, type setting, printing, distribution, sale and handling costs" in connection with the book itself (CX 7). Fred Meyer's expenditures for other services, such as newspaper and radio advertising, payroll, prizes, signs and freight, were not compensated for by the $350 (or any other flat sum) payment.

There is, therefore, no evidentiary support for the Commission's finding that the total cost of the promotional

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[12] These figures are derived from tabulations introduced by Commission counsel. Other Commission exhibits reflect approximately the same amounts. These exhibits indicate that in 1956 total receipts toward the coupon book expenses were $9,250 (CX 13); in 1957, $8,100 (CX 200); and in 1958, $9,415 (CX 201).

services and facilities performed by Fred Meyer was compensated for by the amounts received from suppliers for the purchase of coupon book pages. Nor is there evidentiary support for the ultimate conclusion of the Commission that a portion of the supplier payments did not constitute compensation to Fred Meyer for the furnishing of the various promotional services and facilities. In short, while the evidence is inconclusive as to the total expenses incurred by Fred Meyer, there can be no question on this record but that expenditures substantially exceeded the amount which the Commission has found to constitute "true" promotional payments.

In any event, this is quite irrelevant. As a matter of law, the cost to Fred Meyer of the services and facilities rendered by it are not required to equal the dollar payments made in consideration of such services and facilities. *Lever Brothers Co.,* 50 F.T.C. 494 (1953). This is only common sense, since, for example, the value to a seller of a large aisle display in each of petitioners' thirteen stores cannot be measured with any degree of precision in terms of dollars and cents, although it is obviously something of great value to the supplier. Thus, promotional payments by sellers are made in consideration of "value" of services and facilities rendered, not on the basis of an equation of dollars (*Id.* at 511).

The Commission itself has recognized that, where a supplier's payment is intended to constitute compensation for the furnishing of promotional services and facilities, such payment cannot be construed to be other than a promotional allowance unless there is obvious subterfuge. In *Giant Food, Inc.,* 58 F.T.C. 977 (1961), Giant was charged with unlawfully inducing and receiving payments from its suppliers and it was alleged ". . . that the respondent did not expend the entire amount of money received from each in advertising his particular products, but unlawfully diverted substantial amounts thereof to its own use" (*Id.* at 1009). Dismissing this allegation, the Commission stated:

> Although Section 2(d) of the amended Clayton Act does not authorize payments for services grossly in

> excess of their cost or value, neither does it prohibit a seller from compensating his buyers for any type of service provided its other standards are met, including a reasonable relationship between the payments and the services being rendered . . . The record in this proceeding, however, affords no criteria for evaluating, separately from the media advertising services performed, the relationship which existed between the payments induced by the respondent and the benefits or values conferred on the suppliers by the in-store facilities and services furnished. For that reason, we are unable to say that the combined value of the in-store services and the aforementioned media advertising was not reasonably related to the amount of the suppliers' payments. There is, therefore, a failure of proof of the allegation that a part of such funds was diverted for respondent's own use. (*Id.* at 1010).

Such a failure of proof has clearly occurred in the present case. A full review of the findings of the Commission, in light of the evidence of record, permits no conclusion other than that the Commission has arbitrarily categorized certain portions of the challenged transactions solely for the purpose of supporting an order against petitioners. The arbitrariness of the Commission's findings is well demonstrated by an examination of the complaints issued against the suppliers of Fred Meyer alleged to have unlawfully participated in the coupon book promotions. Thus, complaints were issued on May 15, 1959, the same day as the complaint against Fred Meyer was issued, against Burlington Industries, Inc. (Dkt. 7493); Cannon Mills Company (Dkt. 7494); Idaho Canning Company (Dkt. 7495) and Tri-Valley Packing Association (Dkt. 7496). While in this case the Commission has charged that the payments by Burlington and Tri-Valley constituted violations of both sections 2(a) and 2(d), the complaints against the suppliers themselves charged violations, involving precisely the same transaction, *only of section 2(d).* In short, in proceedings against the suppliers, the payments here found to have violated sections

2(a) *and* 2(d) were specifically charged to have been within the purview *only* of section 2(d).[13]

In its proceeding before the Commission, Tri-Valley maintained that the payments to Fred Meyer were *not* cognizable under section 2(d) as they were not granted in consideration for the furnishing of any services by Fred Meyer in the sale or offering for sale of Tri-Valley products. Rather, Tri-Valley contended, the payments were made to induce or facilitate the *original sale* of the goods without exacting benefits, services or facilities from Fred Meyer. Rejecting this contention, the Commission specifically found that the allowances granted Fred Meyer were "for merchandising services furnished . . . in the resale" of Tri-Valley products and, therefore, constituted promotional payments within the meaning of section 2(d). *Tri-Valley Packing Association*, Docket 7496, Opinion of the Commission (May 10, 1962), p. 8.

Tri-Valley repeated its contention before this Court on petition to review the Commission's decision. This Court indicated that, had Tri-Valley's payment been made to induce the "original sale" rather than as consideration for the furnishing of services and facilities in the resale of the product, the transaction might well have been outside the scope of 2(d) and cognizable under 2(a), but held:

> Our review of the evidence convinces us that the Commission was warranted in finding that the allowances

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13 Thus, the Commission's complaint against Tri-Valley alleged:

> PARAGRAPH FIVE: In the course and conduct of its business in commerce, respondent has been and is now, paying advertising and promotional allowances to certain favored customers without making the allowances available on proportionally equal terms to all other customers competing in the distribution of their products.
>
> For example, respondent has participated in the periodic promotion plans of Fred Meyer, Inc., of Portland, Oregon, occurring annually for many years. In 1957 respondent paid $350 for participation in a coupon book program occurring during September and October. In addition to this, respondent redeemed about 27,750 coupons at the September 1957 price of canned peaches, the net effect of which was to pay Fred Meyer, Inc., the value of one can of peaches for every two actually purchased.
>
> Such allowances were not offered or made available on proportionally equal terms by respondent to all other customers competing in the resale of respondent's products with that customer receiving the allowances.

> given Central Grocers and Meyer were in compensation for the promotion, over a period of time, of Tri-Valley's line of products, and were not given exclusively, if at all, to facilitate the original sale by Tri-Valley to those two customers (329 F. 2d at 708).

Furthermore, in its complaint against Cannon Mills, the Commission challenged the payments to Fred Meyer *only* under section 2(a). Indeed, the only payment which the Commission, in complaints against the suppliers, has charged was made in violation of both sections 2(a) and 2(d) was that of Idaho Canning Company, and this case was not litigated.[14]

It must be concluded, therefore, that the Commission has erroneously and arbitrarily interpreted the supplier payments here challenged; that such payments are not cognizable under the section 2(a)-2(f) charge; and that Count I of the complaint must be dismissed.

III. THRESHOLD QUESTION NO. 2: DOES SECTION 2(d) OF THE CLAYTON ACT REQUIRE A SELLER WHO OFFERS OR GRANTS PROMOTIONAL BENEFITS TO A RETAIL CUSTOMER TO OFFER PROPORTIONALLY EQUAL BENEFITS TO ITS WHOLESALE CUSTOMERS

With respect to two of the suppliers involved in this case, the Commission has found violations based solely upon the alleged granting of discriminatory promotional benefits to Fred Meyer vis-a-vis certain wholesale customers of such suppliers. Idaho Canning is alleged and has been found to have disfavored Hudson House and Wadhams & Co., and Tri-Valley is alleged and has been found to have disfavored Hudson House alone. In addition, Philip Morris Company is alleged and has been found to have granted disproportionate promotional benefits to Fred Meyer vis-a-vis two other customers, one of which, United Grocers, is also a wholesaler.

It is petitioners' position that these suppliers, within the meaning and terms of section 2(d), were not required

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[14] Idaho Canning consented to an order to cease and desist. *Idaho Canning Co.,* 58 F.T.C. 657 (1961).

to offer to their wholesale customers promotional benefits proportionally equal to those granted Fred Meyer, a retailer. However, the Commission, in reversing long-standing precedent, has erroneously interpreted section 2(d) to mean that a seller which offers promotional payments to its retail customers must offer proportionally equal payments to its wholesale customers, disregarding the fact that wholesale customers do not functionally compete with the retail customers (R. 85-93).

This issue, one of first impression before the courts, presents a question of far-reaching import transcending the instant case. If affirmed, the Commission's novel interpretation of section 2(d) in this respect will impose an unreasonably harsh and onerous burden upon Fred Meyer in complying with any order issued under section 5 and will serve to revolutionize existing merchandising practices in many industries. Moreover, the Commission's construction of 2(d), in addition to being contrary to law, is beyond the scope of the issues as defined in the complaint.

There can be no question that Hudson House, Wadhams & Co. and United Grocers are wholesalers and operated solely in this capacity with regard to the challenged transactions herein involved.

First, regarding Hudson House, this Court in *Tri-Valley, supra,* noted that Hudson House is principally a wholesaler which owns several retail grocery stores, operated under the name "Piggly Wiggly," in the Portland area. Tri-Valley contended that Hudson House dealt with these stores in the same manner as it did with independent retailers, *i.e.,* in a wholesale capacity. The record in the present case supports this conclusion. Thus, the Vice President and Manager of Hudson House's wholesale division described his company's business as a "wholesale grocery business" (R. 243). Likewise, the General Manager of Oregon Piggly Wiggly testified:

> Q. Hudson House, Incorporated, is a wholesale grocery firm, isn't it, sir?
> A. Correct (R. 313).

In any event, the fact that Hudson House owned three of the 34 Piggly Wiggly stores in the Portland area (CX 96; R. 313) is immaterial since all transactions with Hudson House in this case involve only its operations as a wholesaler, *i.e.,* the alleged discriminatory prices and allowances relate only to dealings with Hudson House itself and not with the individual Piggly Wiggly stores.

United Grocers is a non-profit buying cooperative owned by approximately three hundred retail grocers located throughout the State of Washington (R. 547-49). Insofar as the transactions in this case are concerned, United Grocers acted solely in a wholesale capacity with respect to its members, and is similar to Central Grocers, Inc., one of the allegedly favored customers in the Boston, Massachusetts portion of the *Tri-Valley* case. This Court held that Central Grocers, a quasi-cooperative owned by approximately one hundred retailers in the Boston area, operated as a wholesaler with regard to its retailer-members, buying goods from Tri-Valley and other sources, warehousing them in Boston, and reselling them to such members (329 F.2d at 706).

Similarly, Wadhams & Co., which supplies products to approximately 85 independent retail stores in the Portland area from its own warehouse and approximately 300 independent retailers from its three "cash and carry" units located in Portland, is a wholesaler (R. 265-66).

Prior to the present case, the Commission itself had held that section 2(d) does not require a seller to grant promotional benefits to wholesalers and retailers on equal terms. *Liggett & Myers Tobacco Co., Inc.,* 56 F.T.C. 221, 250-52 (1959). The Commission has consistently made it clear, in orders involving the alleged inducement of disproportionate promotional allowances under section 5 of the Federal Trade Commission Act, that such orders apply *only* to the inducement of allowances which are not made available to customers who, in fact, compete with the buyer in the resale and distribution of the supplier's products. For example. the order in *The Grand Union Co.,* 57 F.T.C.

382 (1960), which is typical, prohibited the respondent from:

> Knowingly inducing, receiving or contracting for receipt of anything of value as compensation or in consideration for advertising, promotional displays or other services or facilities furnished by or through respondent in connection with the sale or offering for sale of products sold to respondent by any of its suppliers, when such payment is not affirmatively offered or otherwise made available by such suppliers on proportionally equal terms *to all their other customers competing with respondent in the sale and distribution of the suppliers' products* (*Id.* at 416; emphasis added).[15]

Likewise, Commission orders under section 2(d) have made it clear that the requirement of proportional equality extends only to customers who, in fact, compete with the recipient of the payment or allowance. A typical 2(d) order thus requires the respondent to make proportionally equal payments to: "all other such customers competing in fact with such favored customers in the resale or distribution of such products. . . ." *Sperry Rand Corp.,* 55 F.T.C. 655, 663 (1958); to the same effect, see, *e.g., Ronson Corp.,* 55 F.T.C. 1017, 1031 (1959); *Westinghouse Electric Corp.,* 56 F.T.C. 380, 386 (1959); *Bayuk Cigars, Inc.,* 56 F.T.C. 881, 885 (1960).

No previous order of the Commission has included the further clause, which is contained in the order against petitioners: "including other customers who resell to purchasers who compete with respondents in the resale of such supplier's products" (R. 58).

Heretofore, it has been well settled that companies which sell to different classes of customers, *e.g.,* consumers and retailers, obviously perform different distributional functions and therefore cannot be deemed "competitors" in the distribution and sale of the products involved. Thus, in *Liggett & Myers Tobacco Co.,* 56 F.T.C. 221 (1959), the

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[15] To the same effect, see *Giant Food, Inc.,* 58 F.T.C. 977, 1012 (1961); *American News Co.,* 58 F.T.C. 10, 30 (1961).

Commission held, on the basis of existing precedents, that vending machine operators selling at the retail level to consumers were not "competing in the distribution of such products or commodities," as that phrase is used in section 2(d), with wholesalers selling to retailers. The Commission held in that case:

> It is obvious that vending machine operators and wholesalers are engaged in different operations. They do not cater to the same class of customer: the vending machine operator sells to the ultimate consumer, whereas the wholesaler sells to the retailer who in turn sells to the ultimate customer. Since they do sell to different classes of customers, the functions they perform in the distribution of cigarettes are different (56 F.T.C. at 251).

The Commission did not presume to find that the retail customers of Wadham's, United Grocers and Hudson House were "indirect customers" of Tri-Valley, Idaho Canning or Philip Morris. Obviously, it could not make such a finding in the absence of evidence showing that those suppliers dealt directly with such retailers and controlled the prices or terms of sale upon which they purchased. Thus, the Second Circuit has held: "If the manufacturer deals with a retailer through the intermediary of wholesalers, dealers, or jobbers, the retailer may nevertheless be a 'customer' or 'purchaser' of the manufacturer *if the latter deals directly with the retailers and controls the terms upon which he buys*" (Emphasis added). *American News Co.* v. *Federal Trade Commission,* 300 F. 2d 104, 109 (2d Cir. 1962). See also, *Tri-Valley Packing Association* v. *Federal Trade Commission,* 329 F. 2d 694, 709 (9th Cir. 1964); *K.S. Corp.* v. *Chemstrand Corp.,* 198 F. Supp. 310 (D.N.Y. 1961); *Champion Spark Plug Co.,* 50 F.T.C. 30 (1953); *Kraft-Phenix Cheese Corp.,* 25 F.T.C. 537 (1937).

Arguably, the "indirect customer" doctrine can be justified on the ground that a seller who deals directly with purchasers from its customer knows the identity of such purchasers, is, therefore, able to ascertain the amount of their purchases, and is in a position to proportionalize promotional payments to them. In the absence of such

direct dealing and control over the price and other terms of sale, it cannot be contended that a seller is obligated under the statute to proportionalize payments among retailers who purchase from its customers.[16]

Indeed, this Court expressly rejected such a contention in its *Tri-Valley* decision, *supra*. There, answering the argument that Tri-Valley was obligated to offer direct buying retailers an allowance which was proportionally equal to the payments made to Central Grocers, a wholesaler, the Court held:

> As to them [the allegedly disfavored retailers] the only way of showing a section 2(d) violation would be to treat Central Grocers' retail outlets as "indirect" customers of Tri-Valley. This, however, may not be done in the absence of a showing that Tri-Valley engaged in a course of direct dealing with those retail outlets. No such showing was made here (329 F. 2d at 709).

Correspondingly, the Court held that Hudson House, which operated as a wholesaler insofar as the transactions involved were concerned, was not entitled to receive promotional benefits from Tri-Valley proportionally equal to those granted Fred Meyer. The Court held:

> No section 2(d) violation was shown as to the wholesale operation of Hudson House, because that operation was not in functional competition with Meyer, and it was not shown that the independent retailers served by Hudson House were "indirect" customers of Tri-Valley (329 F. 2d at 710).

Obviously, the Commission's holding in the present case is directly contrary to this Court's *Tri-Valley* ruling. See also, *Alhambra Motor Parts* v. *Federal Trade Commission*, 309 F. 2d 213 (9th Cir. 1962).

In addition, the Commission has ignored the fact that Congress, in providing in section 2(d) that a seller must make payments on proportionally equal terms "to all other

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16 It is a much more strained interpretation of the law to require a *buyer* to assure that its suppliers have proportionalized promotional payments among such indirect customers as the Commission attempts to do through its order in this case.

customers competing in the distribution of such products or commodities,'' did not intend to expand the applicable concept of competition beyond the level of the ''customer'' receiving an allegedly discriminatory payment. In contrast, however, 2(a) prohibits price discriminations which may ''prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, *or with customers of either of them . . .*'' (emphasis added). Thus, in 2(d) Congress prohibited non-proportional payments where two requirements are satisfied: (1) The persons accorded non-proportional treatment must be ''customers'' of the seller, and (2) they must be ''competing'' customers.

In 2(a), however, Congress prohibited price discriminations between ''purchasers''[17] where the effect may be to prevent competition with (a) the person granting the discrimination, (b) the person knowingly receiving the benefit of the discrimination, or (c) customers of either of them. In a proceeding under 2(a), a seller who discriminates in price against a wholesale customer and in favor of a direct retail customer may be found to be in violation of the law where the discrimination adversely affects the ability of the wholesaler's customers to compete with the favored retailer. For example, in *Federal Trade Commission* v. *Morton Salt Co.,* 334 U.S. 37, 55 (1948), the Supreme Court upheld that portion of a 2(a) order which prohibited the respondent from ''selling such products to any retailer at prices lower than prices charged wholesalers whose customers compete with such retailer.'' In so ruling the Court relied upon 2(a)'s prohibition against discriminatory prices which adversely affect competition with "any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them.'' No such provision appears in 2(d).

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[17] The terms ''purchaser'' and ''customer'', as used in various sections of the Robinson-Patman Act, are synonymous. See Austin, *Price Discrimination and Related Problems under the Robinson-Patman Act,* 2d Ed. Rev. (1959), p. 120.

More recently, the Supreme Court has held that where Congress, in the Robinson-Patman Act, intended to expand the applicable concept of competition beyond a particular distributional level, it did so in express terms, as in section 2(a). In ruling that a manufacturer is not a "competitor" of a non-integrated retailer competing at the retail level with the manufacturer's direct customers, the Supreme Court held in *Federal Trade Commission* v. *Sun Oil Co.*, 371 U.S. 505, 514-15 (1963):

> Thus, since Congress expressly demonstrated in the immediately preceding provision of the Act that it knew how to expand the applicable concept of competition beyond the sole level of the seller granting the discriminatory price, it is reasonable to conclude that like clarity of expression would be present in § 2(b) if the defense available thereunder were similarly intended to be broadly read to encompass, as is urged, the meeting of lower prices set not only by the offending seller's competitor, but also by the purchaser's competitor. There is no reason appearing on the face of the statute to assume that Congress intended to invoke by omission in § 2(b) the same broad meaning of competition or competitor which it explicitly provided by inclusion in § 2(a); the reasonable inference is quite the contrary.

Because the Supreme Court, in the *Sun* case, held that the term "competitor" in 2(b) means a person competing at the seller's level, it is both logical and necessary, in accordance with principles of statutory construction, to conclude that the term "customers competing" in 2(d) means persons competing at the customers' level and does not refer to all persons who engage generally in the overall distribution of the products involved.[18]

In the present case the Commission admits, as it must, that Fred Meyer did not compete with wholesalers in the direct resale of any product. Thus, the Commission found that ". . . only the retailer-customers of these two whole-

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[18] Similarly, in *Chicago Sugar Co.* v. *American Sugar Refining Co.*, 176 F.2d 110 (7th Cir. 1949), the court held that distributors of sugar and industrial users who bought direct from the refiner could not be deemed to be "customers competing in the distribution of the commodity."

salers [Hudson House and Wadhams] compete with respondents in the direct resale of the goods to consumers'' (R. 89). It asserted, however, that wholesalers, who admittedly do not compete with Fred Meyer in the resale of goods to consumers, are somehow in competition in the ''distribution'' of the products. This conclusion is basically unsound, both as a matter of policy and of statutory construction. The phrase ''competing in the distribution,'' as used in 2(d), can, at most, mean competition in one of the four distributional functions described in 2(d): (1) processing, (2) handling, (3) sale, or (4) offering for sale. Since the Commission has admitted that Fred Meyer did not compete with wholesalers ''in direct resale'' of goods, it would clearly require a strained construction of the statute, and the evidence in this case, to contend that it competed with wholesalers in the ''processing,'' ''handling,'' or ''offering for sale'' of the goods in question. In any event, the matter was laid to rest by the Supreme Court's ruling in *Sun Oil, supra.*

The only case cited by the Commission in support of its unprecedented interpretation of the statute is *Krug* v. *International Telephone & Telegraph Corp.*, 142 F. Supp. 230 (D. N.J. 1956) (R. 93). This case is not inconsistent with this Court's decision in *Tri-Valley* or the Supreme Court's decision in *Sun Oil.* In the *Krug* case, the district court indicated, in ruling on a motion to dismiss the complaint for failure to state a cause of action, that a violation of 2(d) may occur where a manufacturer gives a direct buying retailer a promotional allowance which is not offered to a distributor. But it should be noted that in *Krug* the distributor possessed an exclusive territorial franchise which authorized him to sell to franchised retailers. This franchise arrangement, of course, placed Krug in a position essentially analogous to that of a distributor integrated forward to the retail level. The franchise arrangement thus placed Krug's customers in a position analogous to ''indirect customers'' of the manufacturer. In discussing the analogous situation in *Sun Oil,* the Supreme Court indicated, without ruling on the question, that an inte-

grated supplier-retailer should be deemed to be a "competitor" of a supplier selling directly to an independent retailer within the meaning of the Robinson-Patman Act. In short, the *Krug* case involves nothing more than a special application of the familiar "indirect customer" doctrine and is, therefore, distinguishable on its facts from such cases as *Tri-Valley, Sun Oil* and the present case.

In an effort to avoid the thrust of the foregoing argument, the Commission erroneously stated that the result reached in *Morton Salt, supra,* which involved 2(a), would likewise be reached if Congress, while retaining its present description of price discrimination in 2(a), "i.e., 'discriminate in price between different purchasers,' had made it a *per se* provision like section 2(d) and thus omitted completely all reference to the three levels of competition at which injury can occur" (R. 91). This argument is patently unsound; this is precisely what Congress did not do in 2(a). Congress did *not* say in 2(a) "discriminate in price between different *competing* purchasers," and nothing more. Such a change in the language of 2(a), however, would clearly be required if the analogy which the Commission has attempted to draw between 2(a) and 2(d) were valid. But more than this, the Commission's argument is based on unfounded assumptions: *If* the statute read differently and *if* the *Morton Salt* case were before the Supreme Court under a different statute, the Court would rule the same way as it did.

Moreover, under 2(a), a reasonable probability of competitive injury must be clearly and definitely shown. Congress, on the other hand, made 2(d) a *per se* section. Because of the nature of *per se* violations and the absence of any opportunity for affirmative justification, plus the fact that the Commission is relieved of the burden of showing injury, it is illogical and unfair to assume that Congress meant by its silence to include, by way of construction of 2(d), something which it specifically included in 2(a), a *non per se* section. Indeed, the Commission has recognized that 2(d) ". . . is in itself a very narrow definition of an illegal trade practice" and "covers a limited

area,'' as distinguished from section 2(a). *Vanity Fair Paper Mills, Inc.,* CCH Trade Reg. Rep., 1961-63 Transfer Binder, ¶ 15,796, at p. 20,610 (1962). The very rationale supporting a *per se* application to 2(d) is that it describes a specific and narrow practice which Congress deemed ''always led to the undesired effects on competition.'' *Grand Union Co.* v. *Federal Trade Commission,* 300 F.2d 92, 99 (2d Cir. 1962).

Furthermore, the complaint issued herein prohibited the Commission from concluding that the failure of sellers to proportionalize payments for services and facilities among wholesalers and retailers was violative of 2(d). Paragraph 10 of the complaint alleged that Fred Meyer had induced payments from certain suppliers, and that ''such payments, allowances, services and facilities were not made available by these suppliers on proportionally equal terms to all other customers of such suppliers *competing with respondents* in the sale and distribution of such products'' (emphasis added).

Similarly, paragraph 11 of the complaint alleged that the suppliers did not make such payments available to ''all their customers *competing with respondents* in the sale and distribution of their products . . .'' (emphasis added).

The Commission is bound by its own complaint. At the trial, petitioners were entitled to rely upon the allegations of the complaint and the law with respect thereto as delineating the scope of the issues, legal and factual. Petitioners had no notice that the Commission might consider changing the law by imposing the novel requirement that payments for services and facilities accorded to a direct buying retailer must be offered to a wholesaler.

Because the existence or non-existence of competition is a fact to be determined by observation and not by the processes of logic,[19] it was improper and a denial of due process for the Commission to rule, without notice or an opportunity to defend, that competition exists, ''as a matter of law'' and as a matter of ''statutory interpretation,''

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[19] *International Shoe Co.* v. *Federal Trade Commission,* 280 U.S. 291, 299 (1930).

between sellers shown to be operating at different distributional levels and selling to different classes of customers.

For the foregoing reasons, there is clearly no warrant in law for the Commission's unprecedented ruling that section 2(d) compels equality in promotional payments as between wholesalers and retailers.

IV. THE COMMISSION FAILED TO PROVE THAT PAYMENTS BY ANY OF THE SUPPLIERS INVOLVED VIOLATED SECTION 2(a) OR 2(d)

A. The Law

The payments by Fred Meyer's suppliers can in no sense be construed to fall within the purview of section 2(a) (see *infra,* pp. 16-26). However, assuming *arguendo* that such payments are cognizable under section 2(a) and, consequently, 2(f), the evidence cannot support the Commission's finding that any supplier violated that section. In order to establish a 2(a) violation, there must be a showing of the following essential elements:

(1) That the seller charged with violation sold goods to different customers at different prices, and that at least one of the sales was in interstate commerce;

(2) That the goods sold at different prices were of like grade and quality;

(3) That the sales occurred at or about the same time; and

(4) That the price differentials created a reasonable probability of substantial competitive injury or tendency toward monopoly.

In order to establish a violation of section 2(d), there must be a showing:

(1) That the suppliers charged with violation were engaged in commerce;

(2) That payments in consideration for the furnishing of promotional services or facilities were made by

such suppliers to one customer in connection with the resale of the supplier's products;

(3) That other customers purchased products of like grade and quality to those in connection with which the payments were made at or about the same time; and

(4) That these payments were not made available to all other competing customers on proportionally equal terms.

Each of these elements must be proved by specific and exact evidence and none can be inferred:

> Antitrust cases and, in particular, Robinson-Patman cases require a meticulous attention to minute details. When dealing with prices, allowances and goods of like grade and quality, the Commission may not indulge in assumptions or presumptions, for these matters are susceptible of exact proof and this is the type of showing which must be made.[20]

Before discussing the specific facts of this case and the insufficiency of the evidence relied upon by the Commission respecting the above essential elements of the violations charged, we first review the law relating to these elements.

1. The Requirement of Like Grade and Quality

Under sections 2(a) and 2(d), when a supplier grants price reductions or promotional payments, the same reduction or payment must be offered to all other customers of such supplier competing in the resale of the products regarding which the price reduction or promotional payment was granted. However, when such reduction or payments are made in conjunction with the sale or promotion of a *particular product,* the supplier is not obligated to grant equivalent benefits *unless* the allegedly disfavored customers also purchased that particular product. Thus,

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[20] *J. Weingarten, Inc.,* Docket 7714, Opinion of the Commission (March 25, 1963), p. 9.

in *Atalanta Trading Corp.* v. *Federal Trade Commission*, 258 F.2d 365 (2d Cir. 1958), the court categorically rejected the argument that all that need be shown is that a supplier, in the general course of his business, granted a promotional allowance to one customer and not to other customers:

> We cannot accept the Commission's expansive interpretation of Section 2(d), namely, that after showing a supplier has sold a general line of products in a given area and has granted allowances to only one customer, it is immaterial whether or not a product of like grade and quality to the one on which the allowance was made was ever sold to any other customers in that area (*Id.* at 368-69).
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> . . . the existence of another competing purchaser of a product of like grade and quality must also be shown and proof thereof is an essential part of the Commission's case . . . The very term, promotional allowance, implies a product to be promoted. To adopt the Commission's argument would be tantamount to striking out from Section 2(d) the qualifying phrase "competing in the distribution of such products or commodities" and overruling the prior decisions holding that "such products" mean products of like grade and quality (*Id.* at 369-70).

Prior to *Atalanta*, the Commission itself had interpreted "products or commodities" to mean products or commodities of "like grade and quality." In *Henry Rosenfeld, Inc.*, 52 F.T.C. 1535 (1956), the Commission declared:

> The law imposes no requirements that a seller give advertising allowances on all his products if he elects to accord them on one or more articles. When granting any promotional payments, however, the law requires that he make them available on proportionally equal terms to other resellers of that article or articles who compete with recipients of the compensation (*Id.* at 1545-46).

While these cases involved section 2(d) charges, the principle applies equally to section 2(a) charges.[21] Thus, while the use of different labels on the same product does not itself prevent a finding that a supplier discriminated in the sale of goods of like grade and quality,[22] other factors may well prevent such a finding.[23] In *Universal-Rundle Corp.*, 3 CCH Trade Reg. Rep., ¶ 16,948 (1964), the question was whether certain plumbing fixtures sold to a private label customer were of like grade and quality to fixtures sold under the manufacturer's own brand. The raw materials and manufacturing operations used in the manufacture of both lines of fixtures were the same. However, certain physical differences existed between the two lines. In dismissing the 2(a) charge, the Commission held that where it appears that compared products have physical differences which are "not merely artificial or fanciful," it is incumbent upon Commission counsel to prove that such differences do not affect the marketability or consumer preference of such product, and, consequently, the grade and quality of such products (3 CCH Trade Reg. Rep., at p. 22,004).

The failure of proof on the question of like grade and quality is discussed below in conjunction with the facts relating to each individual supplier.

2. The Requirement of Contemporaneous Transactions

In addition to proof that the allegedly favored and disfavored customers purchased, stocked and resold goods of like grade and quality, it was the further burden of the

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21 See, *e.g.*, *Corn Products Refining Co.* v. *Federal Trade Commission*, 144 F.2d 211 (7th Cir. 1944), *aff'd*, 324 U.S. 726 (1945).

22 *The Borden Co.*, CCH Trade Reg. Rep., 1961-63 Transfer Binder, ¶ 16,191 (1962).

23 Although the mere fact that different private labels are used by a manufacturer on the same product may not, in itself, prevent a finding of price discrimination in the sale of such products, such fact is significant in determining whether a buyer of such products under one private label knew, or, indeed, could determine that the manufacturer was selling the same product under a different label, to another competing buyer. This issue is treated fully in connection with the question of petitioners' "guilty knowledge" (see *infra*, pp. 85-89).

Commission to prove that such customers purchased, stocked and resold such products at or about the same time. The time interval elapsing between the compensated promotion of a supplier's goods by one customer and the actual sale of products of like grade and quality to competing customers is highly significant. In *Atalanta, supra,* the court rejected the Commission's finding of illegality on the ground that the sales to competing customers "... did not occur even closely within the same time periods as the sales of those products to Giant" (258 F.2d at 371). To interpret section 2(d) as not requiring contemporaneous sales of like products to competing customers, stated the Court, "... would stifle rather than encourage competition and have the practical effect of outlawing all promotional allowances" (*Ibid.*).

The law enunciated in *Atalanta* is unequivocal. Under section 2(d), a supplier, of course, is not obligated to offer an allowance to a competing customer on a sale occurring prior to the time that supplier granted the allowance to one customer. Nor does section 2(d) require that the "terms of an initial sale in a given territory ... freeze the supplier into an immutable position" (*Id.* at 372). The Court stated:

> While it is true that the sale on which the allowance was made occurred after the July 1954 promotional allowances rather than preceding it, it does not follow that without any time limitation whatsoever the supplier was irrevocably committed upon making the first sale to hold open the same promotional allowance to all other prospective purchasers or to refuse to deal with them (*Id.* at 372).

Thus, while the Commission considered it immaterial in *Atalanta* whether the subsequent sale followed the promotional allowances by a matter of weeks or months, the court held that "the time interval is a determining factor" and that, absent proof of contemporaneous sales, it cannot be found that any other competing customer was deprived of the allowances "because there was none" (*Id.* at 372).

The principles enunciated in *Atalanta* were very recently reconfirmed by this Court in *Tri-Valley Packing Association* v. *Federal Trade Commission,* 329 F. 2d 694 (9th Cir. 1964), where it was held that proof that "two customers purchased goods of the same grade and quality from the seller within approximately the same period of time" is an essential part of a *prima facie* case under section 2(d) (*Id.* at 708). Partly because the record failed to show any sale of goods of like grade and quality to a competing non-favored customer "sufficiently close" to the date of the challenged promotional payments, the court set aside the Commission's 2(d) order (*Id.* at 709).

Thus, whether products of like grade and quality were sold to the allegedly favored and disfavored customers "within such a limited period of time so as to be sufficiently contemporaneous to satisfy the Robinson-Patman Act" is a matter of proof which must be adduced in each case. *Krug* v. *International Telephone & Telegraph Corp.,* 142 F. Supp. 230, 235 (D. N.J. 1956). An examination of the evidence in the present case discloses that the Commission failed to prove this indispensable element in many instances.

3. The Requirement of Competition

The existence or absence of competition between the allegedly favored and disfavored customers is solely a question of fact which is susceptible of exact proof and which cannot be inferred. Thus, the Supreme Court declared in *International Shoe Co.* v. *Federal Trade Commission,* 280 U.S. 291, 299 (1930):

> The existence of competition is a fact disclosed by observation rather than by the process of logic . . . .

Likewise, in *Federal Trade Commission* v. *Sun Oil Co.,* 371 U.S. 505, 527 (1963), the Supreme Court stated that, in order to find actual competition between two purchasers,

> . . . both the Federal Trade Commission and the courts must make realistic appraisals of relevant competitive facts. Invocation of mechanical word formulas cannot be made to substitute for adequate probative analysis.

Before there can be a finding of requisite competition in the resale of products between the allegedly favored and disfavored customers, it must, of course, first be established that such customers purchased goods of like grade and quality and that such purchases occurred contemporaneously. In short, actual competition cannot exist and cannot be found to have existed absent a showing that each customer involved purchased and offered for resale to consumers the specific products in question during the relevant time period. But the burden of proving requisite competition does not end with the mere showing of contemporaneous purchases of like grade and quality products. Obviously, two contemporaneous purchasers of identical goods from the same manufacturer located in different cities, or in distinct and separate competitive areas within the same city, do not compete in the resale of *any* products.

It is the position of petitioners that general testimony of customers that they consider themselves to be in competition with certain other customers located within the same city is insufficient as a matter of law to prove actual and effective competition within the meaning of sections 2(a) or 2(d). This is also the position of the Commission. In *Weingarten, supra,* for example, the Commission declared that the mere showing that two grocery chains operate in the same city and purchased identical items from the same suppliers does not constitute proof of actual competition in the resale of such items because

> . . . not all of the stores of any of these chains are in competition with . . . [the favored customer] and there is no showing in this record that the stores shown to compete with . . . [the favored customer] were actually stocking and selling an allegedly discriminating supplier's goods at approximately the time when . . . [the favored customer] induced and received its promotional allowances.[24]

Petitioners acknowledge that this Court, in its *Tri-Valley* decision, *supra,* has rejected the view that actual competi-

[24] *J. Weingarten, Inc., supra,* p. 7.

tion between specific stores must be proved when dealing with two chain customers within a single city who operate solely at the same functional level. Rather, stated this Court:

> It is sufficient in that case to prove that one has outlets in such geographical proximity to those of the other as to establish that the two customers are in general competition, and that the two customers purchased goods of the same grade and quality from the seller within approximately the same period of time. Actual competition in the sale of the seller's goods may then be inferred even though one or both of the customers have other outlets which are not in geographical proximity to outlets of the other customer (329 F. 2d at 708).

Even under this interpretation, however, the evidence in this case fails to establish actual competition between the allegedly favored and disfavored retail customers. There has been no showing, in many instances, that the allegedly disfavored retail customers contemporaneously purchased goods of like grade and quality.

The Commission likewise erred in basing a finding of 2(d) violation on the suppliers' dealings with the allegedly disfavored wholesale customers involved. Wholesalers, of course, do not compete with retailers as their operations are at different functional levels. In order, therefore, to base a finding of a section 2(d) violation on a supplier's dealings with its wholesale customers vis-a-vis its retail customers, it must be established that the retail customers of the wholesalers were engaged in competition with the allegedly favored direct-buying retailer and that such customers of the wholesalers were actually "indirect" customers of the supplier. *Tri-Valley Packing Association* v. *Federal Trade Commission, supra.*

Of the six allegedly disfavored customers involved herein, three, Hudson House, Wadhams and United Grocers, insofar as the challenged transactions are concerned, operated solely as wholesalers. In no instance, however, was it shown that the independent retailers served by these wholesalers were "indirect" customers of the wholesaler's

suppliers. As this Court stated in *Tri-Valley,* this could only have been done by

> . . . showing that . . . [the suppliers] engaged in a course of direct dealing with those retail outlets (329 F. 2d at 709).

Therefore, as to these wholesale customers, there can be no finding of a section 2(d) violation.

B. The Alleged Supplier Violations

1. Burlington Industries, Inc.

The Commission's allegations and findings of violations with respect to Burlington are limited to that supplier's participation in the 1957 and 1958 coupon book promotions. The possibility of Burlington's participation in the 1957 promotion was discussed by representatives of Fred Meyer and Burlington as early as February 1957, and the price and other terms of sale were agreed upon in March of that year (R. 426-27). The terms of Burlington's participation in the 1958 promotion were agreed upon in the spring of 1958 (R. 433-34). Pursuant to the agreement reached, the 1957 coupon book featured Burlington Hosiery, which regularly sold for 98 cents per pair, at 79 cents per pair, or three pairs for $2.25 (CX 4, p. 34). The 1958 coupon book featured Burlington Hosiery, which regularly sold for 98 cents per pair, at 69 cents per pair, or three for $2.00 (CX 24, p. 34). The terms of Burlington's 1957 participation provided that, in consideration for the featuring and promotion of its hosiery, Burlington would grant to Fred Meyer allowances ranging from 50 cents to 94 cents per dozen, depending upon style (R. 429). In connection with the 1958 promotion, Fred Meyer received an allowance of 75 cents per dozen on the hosiery purchased and featured (CX 170-73). The aggregate of these allowances amounted to $1,700 in 1957, and $1,800 in 1958 (R. 69). As the Commission noted, these allowances

were not as great as the amount by which Fred Meyer reduced the price to cousumers (R. 69).[25]

Only one customer of Burlington, Lipman, Wolfe & Co., a retail department store with locations in Portland, Salem and Corvallis, Oregon (R. 438-39), is alleged to have been disfavored in terms of price or promotional benefits vis-a-vis Fred Meyer. The Commission found violations of both section 2(a) and 2(d) with respect to Burlington's dealings with this customer. These findings are erroneous. There has been no showing that Lipman, Wolfe contemporaneously purchased products of like grade and quality to those purchased and promoted by Fred Meyer, or that competition in the resale and distribution of Burlington products actually existed between Lipman, Wolfe and Fred Meyer.

We first consider the evidence regarding "like grade and quality." Fred Meyer, in consideration of the payments by Burlington, featured an aggregate of thirteen different grades of hosiery in the 1957 and 1958 coupon book promotions (CX 4, p. 34; CX 24, p. 34). This hosiery was purchased by Fred Meyer from Burlington under Fred Meyer's private brand, "Rose Dawn" (R. 425). Lipman, Wolfe also purchased under private labels, *viz.,* "Waverly" and "Loveliness" (R. 444, 453-55).[26] For the 1957 coupon book promotion, Fred Meyer purchased the very substantial quantity of 1,743 dozen pairs of hosiery from Burlington for sale during the promotion. These purchases, reflected by orders dated May 29 and 31, 1957, consisted of style numbers 603 (950 dozen), 663M (530 dozen), 660M (50 dozen) and 910M (213 dozen).[27] The purchase orders specified that delivery was to be made between August 20 and September 5, 1957.

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[25] Burlington did not pay a flat sum (as found by the Commission) for the cost of the coupon page (CX 5 A, 23 A).

[26] Burlington's nationally advertised brand is "Cameo." There is no evidence that either Fred Meyer or Lipman, Wolfe handled this brand during the years in question (R. 433, 453-55).

[27] CX 141 A, 142 A, 143 A, 145 A, 146 A, 147 A, 148 A.

Between July 17 and October 23, 1957, the date of expiration of the 1957 coupon book (CX 4), Lipman, Wolfe purchased, under six separate invoices, the comparatively small quantity of 388.5 dozen pairs of hosiery, style numbers 603 (66 dozen), 660 (57 dozen), 649 (74.5 dozen) and 519 (191 dozen).[28] Thus, only 123 dozen of the hosiery purchased by Lipman, Wolfe bore style numbers which correspond with style numbers purchased by Fred Meyer, *i.e.,* styles 603 and 660.

Similarly, for the 1958 coupon book promotion, Fred Meyer placed eleven purchase orders on June 2, 1958, and two at later dates for 4,308 dozen pairs of hosiery, style numbers 515 (880 dozen), 519 (659 dozen), 603 (839 dozen), 660 (746 dozen), 663M (449 dozen) and 910 (735 dozen).[29] The purchase orders specified delivery dates between August 25 and October 1, 1958.

Between August 5 and October 22, 1958, the date of expiration of the 1958 coupon book (CX 24), Lipman, Wolfe purchased, under seven separate invoices, the relatively small quantity of 243 dozen pairs of hosiery, style numbers 510 (13 dozen), 519 (130.5 dozen), 603 (60.5 dozen) and 649 (39 dozen).[30] Only two of these style numbers, 519 and 603, correspond to the style numbers purchased by Fred Meyer and the volume accounted for by these styles amounted to only 191 dozen.

Relying *solely* upon the evidence that some of the hosiery purchased by Lipman, Wolfe bore the same style numbers as that purchased and featured by Fred Meyer, the Commission concluded that purchases of products of like grade and quality had been established. Thus, stated the Commission:

> A supplier's use of identical descriptive data on invoices to favored and non-favored customers con-

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[28] CX 181-86.

[29] CX 157 A, 158 A, 159 A, 160 A, 161 A, 162 A, 163 A, 164 A, 165 A, 166 A, 167 A, 168 A, 169 A.

[30] CX 191-97.

> stitutes probative evidence and establishes, prima facie, the fact of like grade and quality (R. 96).

There is, however, absolutely nothing in the record of this case which shows or suggests that Burlington's style numbers are indicative of grade or quality. Indeed, the evidence is to the contrary.

As noted above, the hosiery purchased and featured by Fred Meyer carried the private label "Rose Dawn" (R. 425). In connection with the coupon book promotions, Burlington agreed to grant allowances to Fred Meyer if, instead of purchasing the usual "seamless or seamfree construction", Fred Meyer would "write up other constructions", *i.e.,* other specifications as to grade and style (R. 428-29). This Fred Meyer did. On the purchase orders placed for the hosiery to be used in connection with the coupon book promotion there was written in longhand Fred Meyer's *own specifications* as to the grade and style of the hosiery.[31]

In view of the fact that Fred Meyer purchased hosiery under its own specifications, it cannot be presumed that this merchandise was of like grade and quality to the regular grades sold to other customers. It was the Commission's, not petitioners', burden to show that the specific compared products were, in fact, of like grade and quality. *Universal-Rundle Corp.,* Docket 8070, Initial Decision (October 28, 1963), p. 17, *aff'd,* 3 CCH Trade Reg. Rep., ¶16,948 (1964).

The Commission also erred in finding that Lipman, Wolfe made contemporaneous purchases from Burlington. As noted previously, price and other terms of sale of the hosiery purchased by Fred Meyer from Burlington for

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[31] A typical specification reads:

Star Mist as Mistone, [sizes] 8½-9-9½-10-10½-11, Rose Dawn ¼ dz. pack individual clear [Rose Dawn] envelopes pressure sensitive label in lower right corner of each envelope showing construction [twin thread] our color, size, length and our retail (98¢) (CX 145 A, see also CX 141 A, 142 A, 143 A, 146 A, 147 A, 148 A, 157 A, 158 A, 159 A, 160 A, 161 A, 162 A, 163 A, 164 A, 165 A, 166 A, 167 A, 168 A, 169 A).

the 1957 promotion were agreed upon in March 1957 (R. 426-27). At the same time, Burlington offered Fred Meyer advertising and promotional allowances of 50 cents to 94 cents per dozen, depending upon the hosiery style involved (R. 429). Purchase of the promoted hosiery is reflected by seven purchase orders dated May 29 and 31, 1957 (CX 141 A, 142 A, 143 A, 145 A, 146 A, 147 A, 148 A). However, there is absolutely no evidence of the terms of sale or allowances granted or offered to Lipman, Wolfe in March 1957, when the arrangements were made, or in May 1957, when the purchase orders were placed. Indeed, there is no evidence that Lipman, Wolfe was even a customer of Burlington in those months, *i.e.*, that Lipman, Wolfe was purchasing hosiery from Burlington in March or May 1957, or at any time proximate thereto. The earliest evidence of purchases by Lipman, Wolfe from Burlington in 1957 is an invoice dated July 17, 1957 (R. 440; CX 181). The most that can be said, therefore, is that Lipman, Wolfe, between July 17 and October 23, 1957, the date of expiration of Fred Meyer's 1957 coupon book (CX 4), purchased under six separate invoices, a comparatively minor total of 388.5 dozen pairs of hosiery (CX 181-86).

Since Lipman, Wolfe's first 1957 purchase evidenced by the record occurred at least four months subsequent to the time the arrangements were made between Burlington and Fred Meyer and approximately two months subsequent to the date of Fred Meyer's purchase orders, it is obvious that the requirement of contemporaneous sales is lacking with regard to the 1957 coupon book promotion.

The same is true with regard to the 1958 promotion. The terms of sale of Burlington's hosiery for the 1958 coupon book promotion were agreed upon in the spring of 1958 (R. 433-34). Fred Meyer placed eleven purchase orders on June 2, 1958, one order on June 4, 1958, and one on August 6, 1958 (CX 157 A, 158 A, 159 A, 160 A, 161 A, 162 A, 163 A, 164 A, 165 A, 166 A, 167 A, 168 A, 169 A).

Each order specified delivery of the merchandise between August 25 and October 1, 1958.

The first 1958 purchase by Lipman, Wolfe from Burlington shown by the record was on August 5, 1958 (CX 197). Between August 5, 1958, and October 22, 1958, the date of expiration of the 1958 coupon book, Lipman, Wolfe purchased, under seven separate invoices, the relatively minor quantity of 243 dozen pairs of hosiery from Burlington (CX 191-97). Thus, while the price and terms of sale of the merchandise purchased by Fred Meyer for use in its 1958 promotion were established in the spring of 1958 (R. 433-34), the evidence as to purchases by Lipman, Wolfe is simply that a purchase was made on August 5 and that other purchases followed. In short, there is absolutely no evidence of the prices or allowances offered to Lipman, Wolfe by Burlington in the spring of 1958 or indeed, that Lipman, Wolfe even purchased during that part of the year. Certainly, this evidence cannot support a finding, essential to the Commission's conclusion, that contemporaneous sales occurred.

Furthermore, while it is, of course, elementary that in order to prove a violation of section 2(d) it must be shown that the supplier charged with treating customers discriminatorily did, in fact, grant one customer promotional allowances which were disproportionate to those granted or offered another, this has not been established.

Section 2(d) makes it unlawful for a supplier "to pay or contract for the payment of" promotional benefits when such benefits are not offered on proportionally equal terms to all other competing customers. Burlington contracted to pay Fred Meyer promotional allowances in or about March of 1957 and 1958 but there is no evidence of Burlington's prices, terms, or offers to Lipman, Wolfe at that time. The evidence merely indicates that Lipman, Wolfe did not receive an *actual* payment of cooperative advertising or promotional allowances from Burlington during the period August to December 1957 (R. 444-45, 456-57). Asked whether Lipman, Wolfe was offered *cooperative advertis-*

ing funds during the limited period of September to October, 1957, the witness from that company replied "I don't think so" (R. 445). There is no evidence, however, that Burlington failed to offer some form of promotional assistance other than cooperative advertising during the relevant time period.

Furthermore, even assuming that Burlington did not offer Lipman, Wolfe proportional benefits during the specific period of Fred Meyer's promotions, this alone does not establish that Lipman, Wolfe was discriminatorily treated. In its Guides For Advertising Allowances And Other Merchandising Payments and Services, the Commission itself explains:

> No single way to proportionalize is prescribed by law. *Any method* that treats competing customers on proportionally equal terms may be used. *Generally, this can best be done by basing the payments made or the services furnished on the dollar volume or on the quantity of goods purchased during a specified time* (Emphasis added).[32]

Thus, if all customers of a supplier are treated proportionally during a "specified time", no violation can be found. And the "best" method of assuring proportionality is by reference to total dollar volume of sales or total quantity of goods sold. Although the Commission does not explain in its Guides exactly what is meant by "specified time", it is petitioners' contention that a calendar year, for example, can be so considered. Indeed, it appears that the Second Circuit has so held. In *Vanity Fair Paper Mills, Inc.* v. *Federal Trade Commission,* 311 F.2d 480 (2d Cir. 1962), the Court, without concerning itself with the specific time promotional payments were made, found disproportionality simply because *total* promotional payments granted during the *year* 1958 "gave Weingarten 3.4% and Childs 2.2% on respondent's *gross*

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[32] 1 CCH Trade Reg. Rep., ¶3980, p. 6076.

sales to them'', while the ''percentages for the other customers, who received no special allowance, ranged from 1.9% to zero'' (*Id.* at 483; emphasis added).

Therefore, in order to conclude that Burlington did, in fact, discriminate in terms of promotional benefits granted to Lipman, Wolfe vis-a-vis Fred Meyer, the evidence must show that Lipman, Wolfe, was discriminated against during the relevant periods of time, *i.e.,* during the years 1957 and 1958. However, the record in this case is totally void of evidence as to Burlington's total dollar volume of sales, or total quantity sold, to Lipman, Wolfe during either of these years (R. 443-44).[33] Nor, is there evidence as to the total receipts of Lipman, Wolfe of promotional allowances from Burlington during 1957 or 1958. It is obvious, therefore, that, absent such evidence, there is no way to determine whether or not Burlington actually treated Lipman, Wolfe disproportionately.

Finally, it is a logical presumption, in view of the extremely large quantity of hosiery purchased by Fred Meyer for the coupon book promotions, that Burlington realized substantial cost savings in its sales to Fred Meyer as compared to sales of substantially lower quantities to Lipman, Wolfe. It was Commission counsel's burden to refute this presumption by specific and exact evidence; this burden was not met.

The failure to adduce such evidence precludes a finding that petitioners knew, or should have known, that cost savings were nonexistent. Since this issue relates directly to the question of petitioners' "guilty knowledge", it is treated in the portion of this brief pertaining to the alleged section 2(f) violation by petitioners (see *infra,* pp. 66-78).

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[33] Commission counsel did not introduce evidence relating to total dollar volume or total quantity of sales by Burlington to Lipman, Wolfe for 1957 or 1958. As noted above, the earliest evidence relating to Burlington's sales to Lipman, Wolfe for 1957 is an invoice dated July 17, 1957 (R. 440; CX 181). Similarly, the first invoice introduced in evidence for 1958 is dated August 5, 1958 (CX 197).

2. Cannon Mills Company

Cannon Mills is alleged to have violated sections 2(a) and 2(d) only with respect to its participation in Fred Meyer's 1956 coupon book promotion. Cannon Mills participated in the 1956 coupon book promotion by granting a 10 cent per dozen allowance on the merchandise purchased for feature and resale during the promotion (CX 114). The 1956 coupon book featured Cannon fingertip towels, which regularly sold for 23 cents each, at "7 for $1.00" (CX 1, p. 37). As the Commission found, the allowance granted petitioners, $750 (R. 69), did not fully compensate for the total amount by which they in turn reduced the resale price of the towels to consumers (R. 68-69).

The only customer which Cannon Mills is alleged to have discriminated against is Roberts Brothers, a retail department store in Portland (R. 83),[34] and the only product which the Commission claims was sold to Fred Meyer by Cannon Mills in violation of the law was "fingertip" towels, of which 7500 dozen were purchased for resale during the 1956 coupon book promotion. These towels, designated as style number 7205-AS, were purchased in March 1956 (5,500 dozen) and October 1956 (2,000 dozen), (CX 119-22, 126-29).

During 1956, Roberts Brothers made three purchases of Cannon fingertip towels, style number 7205-AS (CX 136-39). These purchases, reflected by invoices dated April 12, June 19, and November 15, 1956, totaled only 600 dozen (CX 136-39).

While Cannon Mills' style number on the merchandise purchased by Fred Meyer is the same as that on the merchandise purchased by Roberts Brothers, there is no evidence indicating that the style number was intended to be, or was in fact, indicative of the grade or quality of the towels.

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[34] The Commission in its "Opinion on Exceptions to Proposed Order" erroneously stated that Lipman, Wolfe & Co., rather than Roberts Brothers, was the allegedly disfavored customer of Cannon Mills (R. 150).

Commission counsel unsuccessfully attempted, through the testimony of the Roberts Brothers' witness, to establish like grade and quality, as follows:

> Q. Mr. Miller, I direct your attention to Commission Exhibit 1, Page 37, and ask you if you recognize the fingertip towel? [35]
>
> A. Well, I recognize the towel design, *but as to quality I don't* (R. 385; emphasis added).
>
> * * *
>
> Q. Now, there are items that go to make up the desirability of a towel involving the towel, and its marketability, such as color and weight and border, and the like, are there not, Sir? Those items go to determine whether the customer will buy that towel then?
>
> A. That basically makes up the towel.
>
> Q. Those are the basic things, and those items you can't tell at all by looking at the photograph, can you, sir, which was shown you more closely?
>
> A. No, *the photograph is not evidence of the same item.* I can't say that (R. 390; emphasis added).

There is no other evidence. Yet, the question of like grade and quality is susceptible of exact and specific proof.

Furthermore, it cannot be found that Roberts Brothers competed in the resale of goods of like grade and quality during the relevant time period, *i.e.,* during the period of the 1956 coupon promotion, as there is no evidence indicating that Roberts Brothers even offered fingertip towels for resale at that time. Indeed, the only reasonable inference is to the contrary. On April 12, June 19 and November 15, 1956, Roberts Brothers purchased 200 dozen towels (CX 136-39). The April and June purchases occurred approximately five and three months prior to the promotion, respectively, and the November purchase, of

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[35] This exhibit is the 1956 coupon book. The fingertip towels purchased and featured by Fred Meyer in the 1956 promotion were described in the coupon book as follows:

> All first quality thick absorbent terry. Fringed ends, 8 home decorator colors. Ideal as guest towels, extra large wash cloths (CX 1, p. 37).

course, was made approximately one month after the promotion ended. In view of the small quantity purchased on those occasions, it cannot be reasonably inferred that Roberts Brothers stocked, handled, or resold the fingertip towels during the period of the promotion in competition with Fred Meyer.

Finally, any differential which may have been accorded by Cannon Mills to Fred Meyer, even assuming contemporaneous sales of like grade and quality towels to Roberts Brothers occurred, was cost justified. Although the Hearing Examiner in this case, on the basis of "the invoices of both Fred Meyer, Inc. and Roberts Brothers" found that no cost savings had been realized in connection with the sale to Fred Meyer, the same Examiner found, in a proceeding charging Cannon Mills with a violation of section 2(a) by granting the very allowance here in question, on the basis of voluminous cost justification evidence adduced by Cannon Mills, that the price difference was fully cost justified and directed dismissal of the complaint. *Cannon Mills Company,* Docket 7494, Initial Decision (December 3, 1963).[36]

Consequently, there exists no basis for a finding that Cannon Mills violated the law or for the inference drawn by the Commission that Fred Meyer had reason to believe that the prices received from Cannon Mills were not cost justified. An inference cannot be indulged where it is totally contrary to a proven fact (see complete discussion of this question *infra,* pp. 66-78).

3. Tri-Valley Packing Association

Tri-Valley is alleged to have discriminated against Hudson House, Inc., a wholesale grocery firm (R. 243) by reason of its participation in Fred Meyer's 1957 coupon

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[36] The dismissal of the complaint was affirmed by the Commission on the ground that injury to competition had not been shown. The Commission did not, therefore, reach the cost justification issue. *Cannon Mills Company,* 3 CCH Trade Reg. Rep., ¶16,878 (1964).

book promotion. This is the only transaction challenged by the Commission with regard to Tri-Valley (R. 66-67, 97).[37]

A page in Fred Meyer's 1957 coupon book offered consumers one can of Tri-Valley-packed "My-Te-Fine" yellow cling sliced or halved peaches without cost with the purchase of two cans of the same merchandise (CX 4, p. 60). In consideration for having its peaches advertised and promoted by Fred Meyer in connection with the 1957 coupon book promotion, Tri-Valley agreed to pay $350 for a coupon page and to redeem each coupon submitted by consumers at the current price during the period of the promotion (CX 21).[38]

During September and October 1957, Fred Meyer received, pursuant to previous agreement, 2,200 cases of its private label "My-Te-Fine" fancy sliced and halved peaches for sale during the promotion period (CX 44-47). During the same two months, Hudson House purchased, under its own private label, 175 cases of identically described merchandise (CX 42A-43B).[39] Thus, although both Fred Meyer and Hudson House purchased what appears to be the same product at about the same time, the evidence shows that this very well may not have been the case. There are many grades of "fancy peaches" which are not shown by the invoices of record (R. 260). These grades range from low to middle to high (R. 215), and the grade and quality of peaches varies depending upon the area in which they are grown (R. 252). In this regard, Mr. Rice, Vice President and Manager of the Wholesale Division of Hudson House, testified at some length as to variations in grade within the general classification "fancy" (R. 252-253).

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37 Tri-Valley's participation in Fred Meyer's 1957 coupon book promotion has previously been considered by this Court in *Tri-Valley Packing Association v. Federal Trade Commission,* 329 F.2d 694 (9th Cir. 1964).

38 Pursuant to this agreement, Tri-Valley redeemed 20,750 coupons at 23.2 cents each (CX 26).

39 Hudson House also purchased $918 worth of peaches in other sizes and at other prices during the same period (CX 42-43).

Thus, although the grade and quality of peaches differs depending upon the geographic area in which they are grown (R. 252), the Commission failed to adduce any evidence showing that the Tri-Valley products purchased by Fred Meyer and Hudson House were grown and produced in the same area. Indeed, the witnesses from Tri-Valley were not asked a single question regarding the grade and quality of the peaches sold to Fred Meyer as compared to those sold to other Portland area customers.

Disregarding this lack of evidence, however, the Commission found that like grade and quality of products had been proved since "the independent retailers who competed with respondents had no doubts on the like grade and quality issue" (R. 96). This statement is completely unsupported by the record. Witness Denfield, a retail grocer who purchased peaches from Hudson House, and whose testimony is relied upon by the Commission in sole support of its finding, testified merely that the peaches purchased by him were "just peaches" which "[o]rdinarily may *not* have the same grade in all the cans, that's what I have found" (R. 656; emphasis added).

Six other retail grocers appeared, but nothing in their testimony supports the Commission's conclusions concerning the issue of like grade and quality.[40] To the contrary, this testimony destroys any basis for such a conclusion. While these witnesses testified generally that they purchased peaches and other products, they did not testify that the specific products they purchased were of like grade and quality to products stocked or sold by Fred Meyer. Obviously, they could not so testify in light of the complete failure of Commission counsel to trace to their shelves canned peaches sold by Tri-Valley to Hudson House, their wholesaler (see *infra,* pp. 58-60).

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[40] The retail witnesses called by Complaint counsel were: Meyer (R. 292, et seq.); Jones (R. 509, et seq.); Johnson (R. 520, et seq.); Girod (R. 538, et seq.); Denfield (R. 633, et seq. and R. 652, et seq.); and Griffith (R. 659, et seq.)

Furthermore, while representatives of Tri-Valley appeared as witnesses, their testimony also fails to substantiate the claim that the product purchased by Fred Meyer was of like grade and quality to products purchased by the allegedly disfavored wholesale customer, Hudson House.[41]

However, even assuming that the evidence establishes like grade and quality, there can still be no finding of the violation charged. Since Hudson House is a wholesaler and does not compete functionally with Fred Meyer, it was incumbent upon the Commission to find, under this Court's decision in *Tri-Valley, supra,* "that the independent retailers served by Hudson House were 'indirect' customers of Tri-Valley" (329 F.2d at 710). This has not been established.

Proof is also lacking that Hudson House's customer-retailers stocked for resale the relevant products during the pertinent time period. Indeed, the Commission so admits:

> . . . cans of peaches . . . labeled "Hudson House" . . . can be physically found sitting on the shelves of retailers who compete with respondents, *but it cannot be said with absolute certainty that any particular one of those cans was actually packed by Tri-Valley . . . or any other specific supplier* (R. 94; emphasis added).

Contrary to the Commission's holding, the fact that Hudson House's customer-retailers actually stocked and resold Tri-Valley products during the relevant time period cannot be inferred. The error in so inferring is emphasized and fully demonstrated by reference to Hudson House's operations.

Hudson House purchases peaches from a number of companies other than Tri-Valley (R. 249). Additionally, Hudson House operates its own cannery (R. 249). The Vice President of Hudson House testified that his company has purchased peaches from Flotill, Burkhardt-Richards, Ball,

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[41] See testimony of Tri-Valley representatives Snyder (R. 551, et seq.), and Bare (R. 567, et seq.).

Tri-Valley, and Washington Co-op (R. 249). Altogether, Hudson House carries 42 or 43 different peach items (R. 251). There is no evidence indicating whether the peaches purchased by any of Hudson House's retail customers who testified in this case were packed by Tri-Valley, by some other Hudson House source, or by Hudson House itself. Since private label goods are involved, this information is obtainable only by tracing specific shipments of peaches to the customer-retailers of Hudson House alleged to be in competition with Fred Meyer and showing that these specific shipments had been packed by Tri-Valley. Not only is this evidence totally lacking but Hudson House's Vice President testified that he was even unable to say that *any* of the products sold to Hudson House by Tri-Valley were ultimately resold to *any* customer in the Portland area (R. 255-56).

The testimony of the retail customers of Hudson House which allegedly competed directly with Fred Meyer further emphasizes the impossibility of, and error in, inferring the existence of requisite competition. Mr. Jones, for example, testified that he purchased peaches from Hudson House under the brand names "Hudson House" and "Dundee" (R. 510). He did not, however, identify the specific grade or quality of the peaches or the period of time when he stocked and resold these peaches. Nor is there any evidence which even suggests that the peaches which Jones purchased from Hudson House were supplied by Tri-Valley.

Mr. Girod, another retailer, testified merely that he purchased peaches from Hudson House under "Hudson House", "Standby" and "Del Monte" labels (R. 543-44). He did not identify the specific grade or quality of the peaches which he handled. Nor is there any evidence indicating that any of the peaches which he did handle were purchased by Hudson House from Tri-Valley.

Similarly, Mr. Griffith, another retailer, testified that he purchased peaches from Hudson House, but did not identify the specific grade or quality of these peaches (R. 660).

He admitted that he did no business with Tri-Valley and did not know whether Hudson House had purchased the peaches which he handled from Tri-Valley (R. 669).

Another retailer, Mr. Denfield, testified that he purchased peaches from Hudson House, but he did not identify the dates, grade or quality of such purchases (R. 638, 658). Naturally, Mr. Denfield was in no position to know from whom Hudson House purchased the peaches which were resold to him.

There is, therefore, absolutely nothing in the record of this case which would permit the tracing of products sold by Tri-Valley to the shelves of the customer-retailers of Hudson House. This failure of proof requires dismissal of the complaint as to Tri-Valley.

4. Idaho Canning Company

Idaho Canning Company is alleged to have violated sections 2(a) and 2(d) only with respect to its participation in Fred Meyer's 1957 coupon book promotion. Two customers of Idaho Canning, both wholesalers, are alleged to have been discriminated against: Hudson House and Wadhams & Co.

Idaho Canning's participation in the promotion consisted of a payment of $350 for a coupon book page, plus redemption of 21,367 coupons at 12.1 cents each (CX 16). The total payment of Idaho Canning was made to Fred Meyer in the form of free goods (CX 16; see also CX 39, 205-07, 209-10). Pursuant to agreement between the parties, Fred Meyer's 1957 coupon book offered a one pound can of Fred Meyer's private label "My-Te-Fine" whole kernel or cream style corn free with the purchase of two cans at the regular price of 15 cents per can (CX 4, p. 61).

In connection with this supplier, the decision of this court in *Tri-Valley, supra,* is dispositive. Neither of the allegedly disfavored customers compete with Fred Meyer within the meaning of section 2(d) as both are wholesalers and operate at different functional levels than does Fred

Meyer. Therefore, as this Court ruled in *Tri-Valley,* there must be a showing that the retail customers of such wholesalers were "indirect" customers of Idaho Canning and that such retail customers actually stocked, handled and resold the relevant products in actual competition with Fred Meyer. Commission counsel, however, made no attempt to show, and the Commission did not find, that Idaho Canning engaged in such a course of direct dealing with these customers as to establish, in any sense, requisite "indirect" customer relationships. Nor, has it been established that any retail customer of the wholesalers actually stocked, handled or resold the relevant products of Idaho Canning. Indeed, the Commission admits that the proof in this respect is deficient (R. 94).

With respect to the alleged section 2(a) violation, the evidence establishes that Idaho Canning realized substantial cost savings by reason of the large volume sales of the featured products to Fred Meyer which were not realized on sales to the two wholesalers. Such evidence, standing unrebutted, precludes a finding that petitioners knew or should have known that they were receiving unjustified price concessions. This issue relates directly to the question of petitioners' "guilty knowledge" and is treated fully hereafter (see *infra,* pp. 66-78).

5. Philip Morris Company

In addition to the foregoing evidence which relates to the coupon book promotions, the Commission made certain findings concerning transactions with Philip Morris Company. These transactions involve alleged violations by Philip Morris of section 2(d) and are challenged under Count II of the complaint. It is not charged that Philip Morris granted price discounts in violation of section 2(a) or that Fred Meyer received discounts in violation of section 2(f).

The promotional payments made to Fred Meyer by Philip Morris which are challenged under Count II include: (1) $500 for participation in Fred Meyer's 1956

"Gift Days" promotion; (2) $150 per month during a portion of 1956; (3) $800 paid on October 24, 1956 as consideration for the promotion of Parliament cigarettes during September 1956; and (4) $400 for participation in Fred Meyer's "Thrift Days" promotion in 1957 (R. 47-48). It is alleged that, in granting such promotional allowances, Philip Morris discriminated against two alleged competitors of Fred Meyer, *viz.,* Oregon Piggly Wiggly Company, a retail grocery chain, and United Grocers, Inc., a wholesaler-cooperative.

As to United Grocers, Philip Morris was not obligated to offer promotional benefits proportional to those granted Fred Meyer since United Grocers is a wholesaler and does not compete functionally with Fred Meyer (see *supra,* p. 28).

Furthermore, petitioners contended before the Commission that the two allegedly disfavored customers of Philip Morris received a number of promotional payments during the years 1956-1958 and that since the record is silent as to the comparative volume of purchases by Fred Meyer and the two allegedly disfavored customers, no finding could be made as to disproportionality. Evading this contention, the Commission merely held that the allegedly disfavored customers received only "regular" promotional allowances while Fred Meyer received "special deals" in addition to regular allowances and that since these "special deals" were not affirmatively offered to the allegedly disfavored buyers they were not "available". The Commission further found that even had they been "available", the benefits were "virtually incapable of being offered on 'proportionally equal' terms" (R. 76-77). The Commission erred in so concluding.

The record contains invoices and other documents which indicate that Philip Morris sold various products to United Grocers and Oregon Piggly Wiggly, including "Marlboro", "Marlboro Filter", "Philip Morris", "Philip Morris Longs" and "Benson & Hedges" (*e.g.,* CX 98B, 99B, 100B, 101B,

102B, 108B, 109B, 110B, 111B, 112B). However, the record contains no invoices or other documents showing the sale of any of the foregoing products to Fred Meyer during the years 1956, 1957 or 1958. Thus, the Commission concedes that ". . . the record is silent as to the comparative volume of purchases by respondents on the one hand and those two non-favored buyers on the other . . ." and that "it is impossible to determine whether or not Philip Morris fairly apportioned its promotional money among them" (R. 76).

Nevertheless, the Commission inferred that a violation occurred on the basis of its "regular" versus "special" benefits theory. That actual disproportionality cannot be inferred, however, is obvious.

United Grocers received promotional payments from Philip Morris of $405 in March 1956, $300 in July 1956 and an unknown amount in September 1956 (R. 605-08). In addition, United Grocers received an allowance of 5 cents per carton beginning on February 6, 1956 on Philip Morris long-size cigarettes and 10 cents per carton beginning on July 5, 1956 on Parliament cigarettes (R. 615-16). On August 5, 1956, Philip Morris granted United Grocers a $6.00 per case promotional allowance on Spud cigarettes (R. 617). There is no indication either of United Grocers' total purchases or of its total promotional receipts.

As to Piggly-Wiggly, the witness from that Company was asked by commission counsel prior to his testimony to search his records for payments made to him by Philip Morris. However, the request was narrowly confined to a search with respect to payments in one month of each of two years, namely, September 1956, and April 1957 (R. 307-08; see also R. 319). He testified that on March 25, 1957, Piggly-Wiggly entered into a promotion agreement with Philip Morris in connection with which Piggly-Wiggly retail customers received a six-pack carton of Pepsi-Cola with each carton of cigarettes and that Philip Morris reimbursed Piggly-Wiggly for the cost of the Pepsi-Cola given away. The payment by Philip Morris

was $357.75 (R. 309-10). Significantly, this compares favorably with the $400 payment found by the examiner to have been made by Philip Morris to Fred Meyer in April 1957 (R. 48). Of course, the record does not show the volumes purchased by either Fred Meyer or Piggly-Wiggly, and, therefore, a determination as to whether the $357.75 payment to Piggly-Wiggly as compared to the $400 payment to Fred Meyer was proportional is impossible. However, since Fred Meyer is one of the major retailers in the Portland area and probably enjoys a substantially greater volume than Piggly-Wiggly (CX 363, p. 7), it would be a fair guess that Piggly-Wiggly obtained much better treatment than Fred Meyer. In other words, Piggly-Wiggly received almost as much in dollars from Philip Morris as Fred Meyer although Fred Meyer's purchases were, in all probability, substantially greater. This, of course, is an inference. But it certainly precludes an inference to the contrary, *i.e.,* that Piggly-Wiggly did not receive proportional treatment from Philip Morris.

Moreover, the witness from Piggly-Wiggly admitted that if he had checked his records for payment by Philip Morris in months other than the one month in each year requested by commission counsel, he might have found additional promotional payments by Philip Morris (R. 318-19). Additionally, the time he was given to check his records was short, the Company had just moved their offices, and he had difficulty locating records (R. 319). Although the witness was the General Manager of Piggly-Wiggly (R. 293), he had no personal contact with representatives of Philip Morris; all such contacts were handled by other personnel in the organization (R. 310). Therefore, the witness testified that he had no knowledge other than the fragmentary evidence disclosed by the very limited search of his records (R. 316-17, 318-19).

There is, therefore, no evidentiary basis for determining whether or not promotional allowances paid to Fred Meyer by Philip Morris were accorded or offered on

proportionally equal terms to the allegedly disfavored customers.

Nor is there any merit or proper basis in fact for the Commission's classification of Philip Morris' promotional payments into "regular" and "special" categories. "Regular" allowances offered by Philip Morris, stated the Commission, were those consisting of a particular amount per case purchased, and were directly related to the volume of purchases. "Special deals," on the other hand, stated the Commission, were offers of flat sum payments for specific promotional services performed (R. 77-79). The mere fact, the Commission therefore concluded, that Fred Meyer received "special" allowances and that the allegedly disfavored customer received "regular" allowances, establishes a section 2(d) violation.

Certainly, this is not the law. Proportionalization must be determined by a review of all relevant facts and, as a practical matter, cannot be inferred when there is so much as a possibility that all customers were treated equally in terms of total payments related to total purchases. In short, payment to Fred Meyer of the same amount in "special" allowances as payments of "regular" allowances to other customers would not constitute a *per se* violation of section 2(d). Rather, in order to find such a violation, Commission counsel was required to prove that Fred Meyer in fact received a greater amount, qualitatively or quantitatively, than did other customers. This, of course, has not been proved.

Commission counsel failed to introduce in evidence any cooperative advertising or promotional contracts offered by Philip Morris Company. Copies of Philip Morris' cooperative advertising and promotional arrangements are kept in that company's New York office. This is true of both "regular" and "special" deals (R. 535). However, no witness was called from the New York office, and the Commission made no attempt to obtain this evidence. Thus, even if relevant sales information showing the volumes purchased by the allegedly favored and dis-

favored customers were in evidence, it would still be impossible to determine whether or not the allegedly discriminatory payments made to Fred Meyer were within the terms of the contracts and promotional programs offered by Philip Morris Company to all of its customers.

For all of the foregoing reasons, it must be concluded that the Commission erred in finding that Philip Morris violated section 2(d) in its dealing with Fred Meyer.

V. THE COMMISSION ERRED IN FINDING THAT PETITIONERS KNEW OR HAD REASON TO KNOW THAT THE ALLEGEDLY DISCRIMINATORY PRICES AND PAYMENTS RECEIVED WERE UNLAWFUL.

A. The Alleged Section 2(f) Violations

The Commission's findings of fact are not supported by substantial reliable and probative evidence as required by the Administration Procedure Act, *Universal Camera Corp.* v. *NLRB,* 340 U.S. 474 (1951), and the Commission has applied erroneous legal principles.

Section 2(f) of the Clayton Act makes it illegal for a buyer "knowingly to induce or receive a discrimination in price which is prohibited by this section" (15 U.S.C. §13(f)). A buyer's liability, therefore, must be predicated upon a finding that one or more suppliers did, in fact, violate section 2(a) of the Act. Assuming such violations are shown (which petitioners deny has been done here) the Commission is required further to prove that the buyer knew or had reason to know that the price received was discriminatory and did not fall within one or more of the 2(a) defenses available to a seller.

The Commission's burden of proof under section 2(f) was defined by the Supreme Court in *Automatic Canteen Co.* v. *Federal Trade Commission,* 346 U.S. 61 (1953). There, Automatic Canteen, which held "a dominant position" in the sale of confectionery products through vending machines, solicited and received prices *which it knew* were as much as 33 percent lower than prices quoted by its suppliers to other purchasers.

The Commission held that a *prima facie* case of violation could be inferred from mere proof that the buyer had received such lower prices on like goods "well knowing that it was being favored over competing purchasers" (346 U.S. at 62). This, ruled the Supreme Court, was error. Rather, the Court squarely held, a buyer may *not* be held liable under 2(f) unless the Commission proves a *prima facie* violation of 2(a)—interstate commerce, sales at discriminatory prices, and reasonable probability of injury to competition—and further proves that the lower price which the buyer received was not within one of the seller's defenses, such as cost justification. Still further, if the lower price received by the buyer is "not known by him [the buyer] not to be within one of those defenses" no violation can be found (346 U.S. at 74).

Thus, the Court in *Automatic Canteen* set extremely rigid standards as to the burden of proof which the Commission must carry to find a violation of 2(f). Aside from the technical question of statutory construction, the Court was motivated to vest this extremely heavy burden on the Commission because of the basic conflict between the Robinson-Patman Act and the Sherman Act. Thus, the Court stated that bargaining between buyers and sellers is dictated by broader antitrust policies, and that it was its duty to try to reconcile Robinson-Patman Act interpretations with such "broader antitrust policy". The Court noted that "the Commission has, by virtue of the Robinson-Patman Act, been given some authority to develop policies in conflict with those of the Sherman Act" but made it equally clear that it would not approve liberal statutory interpretation to foster the "engendering of such a conflict" because "simplified enforcement" might "give rise to a price uniformity and rigidity in open conflict with the purposes of other antitrust legislation" (346 U.S. at 63, 74).[42]

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[42] See also, Report of Attorney General's National Committee to Study the Antitrust Laws (1955), p. 196.

In defining the Commission's burden of proof, the Court recognized that "trade experience in a particular situation might afford a sufficient degree of knowledge to provide a basis for prosecution" (346 U.S. at 80). For example, if the Commission shows that a buyer knows that he buys in the same quantities as his competitor and is served by the seller in the same manner or with the same amount of exertion, the buyer might fairly be charged with notice that a substantial price differential cannot be cost justified. The Commission must prove, however, that the buyer actually knew that the methods by which he was served and the quantities in which he purchased were the same as other buyers. On the other hand, if the methods or the quantities differ, the Commission must show that such differences did not give rise to sufficient savings in the cost of manufacture, sale and delivery to justify the price differential and that the buyer knew or should have known such fact. The Supreme Court also held that the Commission might infer, from a showing that the actual cost savings were very small compared with the price differences, that the buyer could not reasonably have believed that the differentials were justified.

In the present case, the Commission failed to meet its burden of proof, as defined in *Automatic Canteen,* in at least five respects:

1. The Commission did not attempt to prove and the record contains no evidence which would support a finding that Fred Meyer, "knowing full well that there was little likelihood of a defense for the seller, nevertheless proceeded to exert pressure for lower prices" (346 U.S. at 79).

2. The Commission failed to prove that the allegedly disfavored buyers purchased in the same quantities as Fred Meyer.

3. The Commission failed to prove that the allegedly disfavored buyers purchased in the same manner and with

the same amount of exertion on the sellers' part as Fred Meyer.

4. The Commission failed to prove that the cost savings on sales to Fred Meyer were small as compared to the alleged price differences. Nor did it attempt to prove that such cost differences could not reasonably have been thought to justify such differentials.

5. The Commission failed to prove that the effect of the alleged price differences "may be substantially to lessen competition or tend to create a monopoly," as required under section 2(a).

1. There is No Evidence of "Pressure" or "Coercion"

The Commission did not contend and there is no evidence which would support a finding that Fred Meyer, "knowing full well that there was little likelihood of a defense for the seller, nevertheless proceeded to exert pressure for lower prices'' (346 U.S. at 79).

Proof that a buyer coerced its suppliers to grant price concessions may well estop the buyer from claiming that it lacked knowledge or reason to believe that the concessions received were unlawful. Such inducement of concessions would obviously have occurred under circumstances which rendered the buyer's claimed lack of knowledge culpable. Thus, in *American News Co.* v. *Federal Trade Commission,* 300 F.2d 104, 107 (2d Cir. 1962), the court found liability on the part of a buyer for the inducement and receipt of promotional allowances and rebates after noting that the buyer had ''threatened to discontinue handling a publication if its publishers refused to comply". There is no such evidence in this case, or even a suggestion of such.

2. The Quantities Purchased By The Allegedly Favored And Disfavored Customers Were Substantially Different

The Supreme Court, in *Automatic Canteen,* held that where the quantities purchased are not the same, or at least substantially the same, the Commission may *not* infer that a buyer who receives an allegedly illegal price discrimination has reason to know that the differential could not be cost justified by his supplier. The Commission has ignored entirely this holding and the relevant evidence.

As to Burlington, for the 1957 and 1958 coupon book promotions, Fred Meyer purchased 1,743 and 4,308 dozen pairs of hosiery, respectively (CX 141A-48B, 158A-68B). Of the 1,743 dozen 1957 purchase, 580 dozen were ordered on May 29, 1957, and 1,163 dozen were ordered on May 31, 1957 (CX 141A-48B). Compared to this, Lipman, Wolfe purchased a total of only 624 dozen pairs between July 17 and November 19, 1957 (CX 181-89).[43] Lipman, Wolfe, therefore, over a four-month period, purchased only about one-third the quantity ordered in two days by Fred Meyer. Moreover, the individual purchases by Lipman, Wolfe were extremely small compared to the two large orders by Fred Meyer, ranging from 28 dozen to 187.5 dozen, the majority of which were in quantities of less than 100 dozen (CX 181-89).

Similarly, for the 1958 promotion, Fred Meyer purchased 4,308 dozen pairs of hosiery, 3,775 dozen of which were ordered on June 2, 1958 (CX 158A-168B).[44] In comparison, Lipman, Wolfe's total 1958 purchases reflected by the record amounted to only 354.5 dozen over a period of three months,[45] and individual purchases ranged from 16.5 dozen

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[43] There is no evidence as to purchases by Lipman, Wolfe prior to July 17, 1957.

[44] Fred Meyer also ordered 350 dozen on June 4, 1958, and 183 dozen on August 6, 1958 (CX 157A-B, 169A-B).

[45] The record does not show Lipman, Wolfe's purchases prior to August 5, 1958.

to 111.5 dozen, only one being in excess of 100 dozen (CX 190-97).

Similarly, with regard to Cannon Mills, Fred Meyer purchased 7,500 dozen fingertip towels for the 1956 coupon promotion, 5,550 dozen being purchased by one order in March for delivery later in the year, and 2,000 dozen being purchased by one order in October (CX 119-22, 126-29). In comparison, the allegedly disfavored customer, Roberts Brothers, purchased only 600 dozen fingertip towels during the entire year 1956, the total consisting of three purchases of only 200 dozen each (CX 136-39).

The substantial difference in the quantity purchased by Fred Meyer from Cannon Mills as compared to the purchases of Roberts Brothers clearly precludes a finding that Fred Meyer knew or should have known the concession received was not justified. Subsequent to the Commission's decision in the instant case, Cannon Mills affirmatively proved, in a proceeding against it, that its price to Fred Meyer was more than cost justified (see *infra*, pp. 76-77).

Likewise, in a single order, Fred Meyer purchased 3,967 cases of cream style and whole kernel corn from Idaho Canning for the 1957 coupon promotion (CX 57). This compares to a total of only 2,200 cases of the same items purchased on six different occasions by Hudson House during the three month period August to October 1957 (CX 50, 51, 58, 60, 62, 65), and to only 80 cases total purchased on three different occasions during August and September by Wadhams (CX 52, 53, 59).

From Tri-Valley, Fred Meyer purchased 1,500 cases of peaches for the 1957 promotion, all of which were shipped and invoiced on the same day (CX 45, 46).[46] In comparison, Hudson House purchased during October a total of only 275 cases of the same items, the largest order being only 200 cases (CX 42A-43B).

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[46] Fred Meyer also purchased 400 cases of peaches on October 10, 1957 and 300 cases on October 29, 1957 (CX 44, 45).

In light of the *Automatic Canteen* holding that "no inference of guilty knowledge" is permissible unless the evidence shows that the alleged favored and disfavored customers purchased in substantially the same quantities, Count I of the complaint must be dismissed.

3. The Methods Of Serving And Amount Of Exertion On The Part Of Suppliers In Connection With Sales To Fred Meyer And The Allegedly Disfavored Customers Differed

The Commission has also ignored the fact that the allegedly disfavored customers of each supplier involved purchased in a different manner and with a different amount of exertion on the seller's part than did Fred Meyer. Agreements as to terms of sale and products to be featured during the coupon promotions were reached many months in advance of the promotion itself (R. 193-44, 208, 359-60, 427, 433-34, 553, 587, CX 119-22) and Fred Meyer took delivery shortly before or during the promotional period (CX 44-47, 49, 54-57, 61, 64, 66, 119-22, 141A-48B, 157A-69B). The allegedly disfavored customers, on the other hand, made small spot purchases for immediate delivery. This fact alone provides a most reasonable basis for petitioners to have believed that sellers could realize cost savings by gearing production and delivery schedules to a known demand at a definite future time. In addition, Fred Meyer sometimes paid transportation costs (R. 367-68). Selling expenses, likewise, were reduced because Fred Meyer's buyers often contacted suppliers' representatives at sales conventions (R. 193, 479), thereby reversing normal sales procedures. Additionally, very large orders were sometimes placed by means of telephone, further reducing the sellers' sales effort (R. 378).

4. There Is No Evidence That The Actual Cost Savings On Sales To Fred Meyer Were Disproportionate To The Alleged Price Differences Or That Fred Meyer Could Not Reasonably Have Believed Such Differences Were Cost Justified.

In an effort to demonstrate an alleged absence of cost savings, both the hearing examiner and the Commission found that Fred Meyer, the *buyer,* did nothing which resulted in cost savings in connection with its coupon promotion purchases (R. 43-46, 133-35), ignoring the fundamental principle that the relevant inquiry in a proceeding involving cost justification requires a consideration of the *seller's* costs. Thus, the assumption that Fred Meyer did nothing which resulted in cost savings, even if true, is irrelevant. The Commission did, however, admit that "neither complaint counsel nor respondents introduced evidence on [the] issue" of the actual costs incurred by suppliers in connection with such transactions (R. 131). Under *Automatic Canteen,* this burden was on the Commission.

In support of its finding of absence of cost justification the Commission relies upon the following testimony of an employee of the *buyer,* Fred Meyer:

Q. Mr. Merrick, in 1956, when Fred Meyer Incorporated, was receiving this $1.55 price from Cannon Mills on Item 7205, did you to the best of your knowledge and recollection do anything different in your company that would result in a cost saving to Cannon?

A. I can't answer what would save Cannon's costs. I'm not qualified to answer that.

Q. Well, did you do anything to change your shipping transactions, anything that would save them freight?

* * *

THE WITNESS: We pay the freight. We can't save Cannon Mills anything.

By Mr. Snyder:

Q. Exactly. Now, did you do anything that would result in a cost saving to Cannon Mills Company

so far as your dealings with the manufacturer's representative were concerned?

A. Well, I couldn't answer that.

Q. Was anything changed before or after the 1956 coupon book promotion, Mr. Merrick?

* * *

Q. To the best of your knowledge and recollection, can you recall anything that would save Cannon Mills money when they dealt with you?

* * *

THE WITNESS: I'm not qualified to say whether Cannon Mills saved money.

By Mr. Snyder:

Q. Did the Cannon Mills representative call on you approximately the same number of times?

A. I can't answer that (R. 367-68).

This simply establishes that Fred Meyer did not know and had no way of ascertaining its suppliers' costs. It was, therefore, incumbent upon the Commission to establish that Fred Meyer's suppliers incurred no cost savings and that Fred Meyer knew or should have known this fact. This it failed to do.

Apparently recognizing the absence of necessary evidence, the Commission attempts to defend the failure to demonstrate the absence of cost savings on the part of Fred Meyer's suppliers by asserting that the cost justification defense is "a one-way street," *i.e.,* while a cost study which demonstrated the existence of sufficient cost savings to account for the price difference would defeat the Commission's case, a study which failed to reveal cost savings would not serve to sustain the Commission's case in the absence of further evidence that respondents knew such to be the fact (R. 130-31). While this statement is accurate, the argument constitutes an abnegation of the Commission's responsibilities as a fact-finding body. Because it apparently believed that only the petitioners could benefit from a factual inquiry into the costs of Fred Meyer's

suppliers, the Commission simply ignored the facts, disregarded *Automatic Canteen,* and purported to focus on "respondents' 'state of mind'" (R. 131).

Thus, the Commission speculated:

> Since respondents are unable to get any price concessions from these suppliers during eleven months out of the year, we think it a fair inference that respondents' purchasing in larger quantities than their competitors, to the extent that they do so, does not give rise to any measurable cost savings for those sellers. If such cost savings existed, why are respondents unable to induce their suppliers to pass them on to them during eleven months of each year? (R. 132).

The fallacy in this inference is obvious. There is no evidence which indicates that Fred Meyer's purchases during eleven months of the year involved quantities which remotely approached the very large quantities which were purchased for the limited four-week coupon book promotion.

For example, although the record shows that Fred Meyer purchased 2,200 cases of peaches (52,800 units) from Tri-Valley for the 1957 coupon promotion (CX 44-47), there is no evidence showing the actual amount of Fred Meyer's purchases from Tri-Valley at other times during the year. There is evidence, however, that Fred Meyer's "present average four weeks sales" during 1957 of the featured peaches amounted to only 27,046 units (CX 28), approximately one-half the amount purchased for the promotion.

Likewise, Fred Meyer purchased, in a single order, 3,967 cases (95,208 units) of canned corn from Idaho Canning for the 1957 coupon promotion (CX 57). Compared to this, while there is no evidence showing the actual amount of Fred Meyer's purchases at other times during 1957, the "present average sale for four weeks" during 1957 of Idaho Canning corn amounted to only 8,760 units (CX 293)

or less than one-tenth the amount of the single purchase for the promotion.

The "present average sale for four weeks" by Fred Meyer of Burlington hosiery during 1957 was 800 to 1,200 dozen pairs (CX 156). There again is no evidence as to Fred Meyer's actual purchases at times other than during the promotion. However, compared to the normal 800 to 1,200 dozen pair average sale for four weeks, Fred Meyer purchased 1,743 dozen pairs for the 1957 coupon promotion (CX 141A-48B), and 4,308 dozen pairs for the 1958 promotion (CX 157A-69B).

Regarding Cannon Mills, Fred Meyer purchased 7,500 dozen towels for the 1957 coupon promotion, 5,500 of which were purchased under one order in March for delivery later in the year, and 2,000 dozen of which were purchased in October, both orders being placed by telephone (CX 119-22, 126-29, 378). The record is totally barren of evidence as to Fred Meyer's purchases from Cannon Mills at other times during the year.

It is obvious, therefore, that Fred Meyer's purchases of the featured items were substantially greater than its regular purchases during the other eleven months of the year. It was error, therefore, for the Commission to infer otherwise.[47]

Further and eloquent proof of the Commission's total disregard of the *Automatic Canteen* rule and the lack of reasonableness in the inferences it has drawn is provided by its findings with respect to the allegedly unlawful concessions granted by Cannon Mills.

In the present case, the Commission has concluded, on the basis of a series of unwarranted inferences, that Cannon Mills' prices to Fred Meyer were, in fact, *not* cost justified. However, in a Commission proceeding against Cannon Mills itself, *in which the challenged transaction*

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[47] Moreover, the record contains no evidence concerning prices actually paid by Fred Meyer to these suppliers during the other eleven months of the year and it is entirely possible that there were in fact cost savings which would have entitled Fred Meyer to lower prices during those months. Suppliers may choose not to reduce prices, even though legally entitled to do so. An inference to this effect is as well founded as the Commission's inference to the contrary.

was precisely the same as that challenged here, Cannon Mills successfully established that the discount to Fred Meyer was fully cost justified.[48] Indeed, the cost saving arising from Fred Meyer's unusually large orders amounted to 12.135 cents per dozen while the discount was only 10 cents per dozen.[49]

The unchallenged conclusion of the examiner in *Cannon Mills* is in direct conflict with the conclusion of the Commission in the present case and emphasizes the necessity that the Commission adduce exact proof on cost justification as required by *Automatic Canteen.* The two contradictory findings also emphasize the fact that a buyer cannot be expected to know the extent to which its suppliers have realized cost savings. The examiner's finding in *Cannon Mills* was based upon a detailed consideration of voluminous cost justification evidence adduced by Cannon Mills. A cost study was conducted under the supervision of a certified public accountant (who devoted 75 per cent of his time over a five month period to the preparation of the study), assisted by scores of accountants, clerks and technicians, and two independent experts.

Petitioners submit that, just as the Commission's categorical finding, based upon inference, that Cannon Mills' prices were unjustified was clearly incorrect, so must it be concluded that the Commission's inferential findings with respect to the other three suppliers charged with violating section 2(a) were incorrect. At a minimum, they are not supported by substantial, reliable and probative evidence as required by the Administrative Procedure Act. *Uni-*

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[48] *Cannon Mills Co.*, Docket 7494, Initial Decision (December 3, 1963); dismissed by Commission, 3 CCH Trade Reg. Rep., ¶ 16,878 (1964). The hearing examiner's findings in the *Cannon Mills* case were issued subsequent to the Commission's decision in the present case. In affirming the hearing examiner's dismissal of the complaint against Cannon Mills, the Commission evaded the cost justification issue. Instead, it ruled that the evidence did not support even the threshold finding of injury to competition, as required by the Act, and, hence, no violation of section 2(a) occurred.

[49] Initial Decision, p. 42. While the examiner in *Cannon Mills* observed that Fred Meyer's purchase, ''although an isolated occurrence, involved a very substantial quantity'' (Initial Decision, p. 16), the Commission in this case declined to even consider the quantities purchased (R. 135-36).

versal Camera Corp. v. *NLRB,* 340 U.S. 474 (1951). Certainly, it was error to infer that these suppliers did not realize cost savings since the quantities purchased, nature of dealings, and other factors relating to the challenged transactions were analogous to those of Cannon Mills.

For example, the representative from Idaho Canning categorically testified that very substantial cost savings resulted in a sale of 500 to 2000 cases as compared to a sale of only 40 to 50 cases. This testimony was neither generalized nor speculative. He pointed out that 14 employees are required to set up and operate a production line. The setting up time in packing 50 cases of private label merchandise is the same as that for an order of 500 cases. In addition, he testified that, on orders of 500 cases or more, the cost per case is four to five cents, whereas, an order of 20 cases might result in a cost as high as fifty cents per case (R. 505-6).[50]

The conclusion is, therefore, inescapable that the Commission, as required by the Supreme Court in *Automatic Canteen,* has failed to come forward with reliable, probative and substantial evidence in support of its inferential finding that the alleged price differentials received by Fred Meyer were not cost justified and that Fred Meyer knew or should have known such to have been the fact. Count I of the complaint should be dismissed.

5. The Commission Erred in Finding Competitive Injury

The Commission found that the price differences received by Fred Meyer from its suppliers were sufficient to create a reasonable probability of competitive injury. However, to this question the Commission has devoted only brief treatment (R. 100-3) and has ignored entirely the fact that the allowances received were "once-a-year" occurrences. If there was any effect on competition because of the price differences, that effect must necessarily

[50] Although this testimony was fully substantiated by Idaho Canning's records (R. 509), the Commission ignored the evidence, contending that it related only to *labeling* costs (R. 134). It is clear, however, that the witness was referring to the cost of production of a small order as compared to a large order and did not confine his testimony solely to labeling.

have been temporary and minimal, and insufficient to support a finding of violation of 2(a). Rather, "there must be something more than an essentially temporary minimal impact on competition and probative analysis must reveal a causal relation between the price discrimination and an actual or reasonably probable injury to competition in the context of the factual situation involved." *American Oil Co.* v. *Federal Trade Commission,* 325 F. 2d 101, 106 (7th Cir. 1963).

Indeed, the Commission has acknowledged that the nature of the concessions received by Fred Meyer for the coupon promotions were not such as to create a reasonable probability of substantial injury to competition within the meaning of section 2(a). In *Cannon Mills Co.,* 3 CCH Trade Reg. Rep., ¶ 16,878 (1964), the Commission dismissed a charge that the very concessions here in issue granted by Cannon Mills to Fred Meyer violated 2(a) because competitive injury or probability of competitive injury had not been shown.[51] Petitioners submit, therefore, that the Commission erred in perfunctorily purporting to find requisite competitive injury here and that Count I of the Complaint must be dismissed.

B. The Alleged Section 5 Violation

In a proceeding under section 5 of the Federal Trade Commission Act involving the alleged inducement and receipt from sellers of disproportionate promotional allowances by a buyer, the Commission must adhere to the principles established in *Automatic Canteen.* It must first prove that the allowances received actually were granted in violation of section 2(d) of the Clayton Act. Assuming

[51] The Commission held:

> . . . While finding a *prima facie* violation by respondent of Section 2(a) of the Clayton Act, as amended, the examiner dismissed the complaint on the ground that respondent had succeeded in its cost-justification defense. Upon examination of the record, the Commission has concluded that the evidence of record is insufficient to prove the requisite adverse effects on competition. Since a *prima facie* violation was not proved, it is unnecessary to reach the merits of respondent's cost-justification defense.

that such violations are established (which petitioners deny has been done here), it is the Commission's further burden to prove that the buyer knew or had reason to know that the allowances received were granted in violation of section 2(d). In the absence of specific proof that the buyer actually knew the allowances received were unlawful, it must be established by circumstantial evidence that the buyer requested such allowances under such circumstances as to render lack of knowledge of illegality culpable. The Commission in the present case has failed entirely to adduce such evidence. Instead, it has relied upon tenuous inferences and has established totally novel tests of liability.

1. The Commission's Contention That A Buyer Who Initiates A Promotional Activity Is Automatically Placed On Notice That Its Supplier's Payments Are Discriminatory Is Incorrect

The Second Circuit has categorically held that section 2(d) ". . . does not ban all promotional allowances, nor even all allowances which are the 'result of private negotiations.'" *Atalanta Trading Corp.* v. *Federal Trade Commission,* 258 F.2d 365, 370 (2d Cir. 1958). Nor does section 2(d) prohibit a promotional plan ". . . tailored exclusively to fit the desires of the two parties negotiating . . ." *(Id.* at 372).

It is clear, therefore, that the mere fact that suppliers participated in Fred Meyer's coupon promotion under individually negotiated terms does not permit a *per se* finding that the suppliers violated the law or that violations were induced by Fred Meyer with knowledge of illegality. Rather, a finding of unlawful inducement can only be made ". . . in circumstances where it appears that such want of knowledge on the buyer's part was culpable. . . ." *Giant Food, Inc.* v. *Federal Trade Commission,* 307 F.2d 184, 187 (D. C. Cir. 1962; emphasis added).

In order to find that Fred Meyer acted culpably, it must be shown that good faith was lacking. Good faith, the Commission has stated in connection with the meeting of competition defense,

> . . . is a flexible and pragmatic, not technical or doctrinaire concept. The standard of good faith is

> simply the standard of the prudent businessman responding fairly to what he reasonably believes is a situation of competitive necessity. . . . Such a standard, whether it be considered "subjective" or "objective", is inherently *ad hoc.* Rigid rules and inflexible absolutes are especially inappropriate . . . the facts and circumstances of the particular case, not abstract theories or remote conjectures, should govern . . .[52]

In complete disregard of the established requirements of proof, the Commission, in an apparent effort to create a new *per se* test of liability, has announced a novel and unsound rule that any buyer who initiates a promotional activity is automatically placed on notice of the possible nonproportionality of its suppliers' payments and is, therefore, under a duty to make affirmative inquiry. Thus, stated the Commission:

> We think the law is plain that a buyer who initiates a promotional service and induces his supplier to pay him for performing it has possessed himself of information sufficient to put upon it the duty of making inquiry to ascertain whether the suppliers were making such payments available on proportionally equal terms to [its] competitors (R. 118).

Never before, absent evidence of culpability, has any court declared that a buyer was obligated to affirmatively inquire of its suppliers as to the legality of the payments offered or made. Indeed, in *Automatic Canteen* the Court stated:

> [T]he Commission may consider that a seller stating that a price would be unlawful might in some situations be puffing rather than stating anything which a buyer can rely on or should be charged with. On the other hand, the Commission may in some circumstances wish to refuse to accept a buyer's claim that he relied on an affidavit or other assurance from the seller that price differentials were cost-justified; *the furnishing of such an assurance might, together with other circumstances, indicate a sufficient absence*

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[52] *Continental Baking Co.*, Docket 7630, Opinion of the Commission (December 31, 1963), p. 2.

> *of arm's-length bargaining to raise serious doubts as to the weight the assurance should be given in support of a buyer's claim* (346 U.S. at 81, n. 24; emphasis added).

Furthermore, the Commission's new rule contemplates that a buyer must assume that its suppliers are engaging in discriminatory practices and are acting unlawfully. Again, this is an irreconcilable conflict with *Automatic Canteen* where the Court stated that it cannot be assumed that price differentials are frequently "within the prohibited range of price discriminations" and that to make such an assumption would render the required proof of "knowledge" meaningless (346 U.S. at 71).

Moreover, such an assumption is directly contrary to the settled principle that there is a presumption that men obey the law. "There is a presumption that business is conducted lawfully . . . and that all things are rightfully done . . . and where the act of a party may be referred indifferently to one of two motives, the law prefers to refer it to that which is honest . . .". *Fidelity and Deposit Co.* v. *Grand National Bank of St. Louis,* 69 F. 2d 177, 183 (8th Cir. 1934).[53]

2. The Nature of the Coupon Promotion Did Not Render Payments of Suppliers Incapable of Proportionalization

The Commission held that Fred Meyer knew or should have known it was inducing and receiving unlawful payments because, in part, such payments were incapable of proportionalization to competing customers. This holding is based primarily on two erroneous grounds: (1) that Fred Meyer required the payments to be "exclusive" with it during the period of the promotion (R. 119); and (2) that the promotion itself was "unique" (R. 123).

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[53] See also *United States* v. *Detroit Timber and Lumber Co.,* 200 U.S. 321 (1906), *St. Joseph Stockyard Co.* v. *United States,* 187 Fed. 104, 106 (8th Cir. 1911), *Athens Roller Mills, Inc.* v. *Commissioner of Internal Revenue,* 136 F. 2d 125, 128 (6th Cir. 1943).

As to the first ground, the Commission relied upon the following legend appearing in the promotion information form:

> Offer Must Be Exclusive at Fred Meyer During the 4 Week Period (R. 119).

The Commission argues that the meaning of this language is that "each supplier who participated in respondents' 'coupon book' promotion agreed with respondents that it would not, during that particular four-week period of time, 'participate' in a similar program sponsored by any other buyers" (R. 120). The record, however, contains no explanation of the meaning, purpose, or operation of the language. Construed as a requirement that participating suppliers could not enter into coupon book promotions of other retailers, as the Commission has done, there is no indication that it was enforced or that there was any occasion to enforce it. The Commission, for example, failed to adduce evidence that any supplier was excluded from the coupon book promotion because of its participation in a promotional activity sponsored by another retailer. Correspondingly, there is no evidence indicating that any other retailer desired to conduct a coupon promotion at the same time as did Fred Meyer and was prevented or hindered from doing so.

In support of the second ground of its holding, the Commission placed weight upon statements found in promotional literature which described the coupon book program as a "unique" advertising medium (R. 123). This is meaningless—every promotion is "unique" to a salesman. In any event, no more can be inferred than that the *theme* of the promotion was unusual. Certainly there was nothing "unique" about the promotion in terms of services and facilities rendered. In consideration for their payments, suppliers received promotional services and facilities commonly utilized by retailers, *viz.*, radio and newspaper advertising, window and in-store displays, signs, banners, sales bulletins, sales meetings and prizes (CX 6, 18, 19). It is obvious, therefore, that suppliers could have formulated proportional programs for all

competing customers, and that such customers would have been able to perform the same services and furnish the same facilities performed and furnished by Fred Meyer if they so desired.

Moreover, it is not necessary that all facets of a particular program be adaptable to the business of all customers. The Commission has consistently ruled that ". . . a comprehensive plan [need not] be so tailored that every feature of it will be usable or suitable for every customer. In many cases that would be an impossibility." *Lever Brothers Co.,* 50 F.T.C. 494, 510 (1953). Indeed, not only does the law permit a seller to pay for services of different types, it sometimes requires him to do so. Thus, in *Exquisite Form Brassiere, Inc.,* 57 F.T.C. 1036 (1960), remanded on other grounds, *Exquisite Form Brassiere, Inc.* v. *Federal Trade Commission,* 301 F. 2d 499 (D. C. Cir. 1961), *cert. denied* 369 U.S. 888 (1962), the Commission declared:

> The customer and not the seller should decide what is or is not usable or suitable for him and should have the opportunity to select that feature of a plan which suits him best (57 F.T.C. at 1050).[54]

Thus, it is well recognized that the ability to provide useful and effective services and facilities may vary greatly among different customers. It is this principle which precludes, as a matter of law, any finding that the fact petitioners received payments for particular services has any probative value in establishing knowledge of illegality.

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[54] While the various types of services and facilities for which a seller may pay promotional allowances have never been completely enumerated by statue or by decisions, examples of some heretofore recognized and approved by the courts and the Commission are set forth in the Commission's "Guides for Advertising Allowances and Other Merchandising Payments and Services" (Adopted May 19, 1960), 1 CCH Trade Reg. Rep., ¶ 3980:

> The following have been held to be services or facilities covered by the law where the seller has paid the buyer for furnishing them: Any kind of advertising, Handbills, Window and floor displays, Special sales or promotional efforts for which "push money" is paid to clerks, salesmen, and other employees of the customers, Demonstrators and demonstrations, Collection of orders from individual stores, Furnishing complete distribution of seller's line.

3. Fred Meyer Neither Knew Nor Had Reason to Know the Specific Prices and Allowances Offered and Granted to the Allegedly Disfavored Customers or even that its Suppliers Sold Products of Like Grade and Quality to Such Customers.

The Commission claimed that Fred Meyer maintained and operated a "vigorous intelligence network" through which it learned that its suppliers sold products of like grade and quality to the allegedly disfavored customers and was informed of the specific prices and allowances granted to such customers (R. 111). This so-called "vigorous intelligence network" consisted merely of such normal and routine activities as checking newspaper advertisements, comparative shopping, checking and testing certain items and reporting by buyers of retail prices of competitors (R. 105-07). The Commission also found that Fred Meyer reviewed price bulletins distributed by unidentified suppliers and brokers and that it maintained a "pretty close" personal contact with the Portland broker of Tri-Valley and Idaho Canning (R. 107-10).

None of these activities, however, informed Fred Meyer of the *actual* prices paid or allowances received by the allegedly disfavored customers or even that they *actually* purchased products of like grade and quality. Indeed, in an incomprehensible statement in view of its affirmative finding, the Commission so concedes: "Respondents' vigorous intelligence network eloquently attests to their quite natural desire to know these things; if they did not succeed in learning them, it was because they lacked the *power,* not the inclination" (R. 111; emphasis in original). This is a patent example of the Commission's refusal to limit its findings to the evidence. Naturally, petitioners possessed the "inclination" to know the prices paid and allowances received by their competitors. But this inclination does not fill the evidentiary vacuum.

Thus, assuming *arguendo* that the suppliers did, in fact, sell products of like grade and quality to the alleged disfavored customers, it is clear that Fred Meyer neither

knew nor had reason to know such fact. With the exception of Cannon Mills, all of the suppliers charged to have violated section 2(d) in granting Fred Meyer payments in connection with the coupon promotions sold *private label* merchandise to Fred Meyer under different labels than used for the merchandise sold to the allegedly disfavored customers (R. 425-26, 452-54; CX 42A-43B, 46-48, 50, 52, 63). Fred Meyer's buyer who purchased from Tri-Valley and Idaho Canning testified:

> To my knowledge, I have never asked a representative of Tri-Valley Packing Association what they are charging other people in this area, or even to whom they sell in this area (R. 218).
>
> * * *
>
> Q. Do you know what other buyers in the Portland area are buying Tri-Valley peaches, for example?
> A. No, sir.
> Q. Do you know what other buyers, if any, in the Portland area are buying Idaho Canning products?
> A. No, sir.
> Q. Did you in 1957?
> A. No, sir.
> Q. Did you in 1958?
> A. No, sir (R. 213-14).[55]

Naturally, if Fred Meyer did not know that the allegedly disfavored customers even purchased from the suppliers in question it could not have known that it competed with such customers in the resale of products of like grade and quality.

In *Tri-Valley,* this Court stated that its view as to the existence of competition in the resale of products of like grade and quality between two customers operating at the same functional level was in keeping with the underlying purpose of section 2(d). The Court explained that

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[55] Uncontradicted and unimpeached testimony as to matters of common observation or within expert knowledge, if not inherently incredible, must be accepted as establishing the facts. *Nishikawa* v. *Dulles,* 356 U.S. 129, 131, 136-37 (1958); *Dickinson* v. *United States,* 346 U.S. 389, 396-97 (1953); *Chesapeake & Ohio R. R. Co.* v. *Martin,* 283 U.S. 209, 214 (1931); *International Shoe Co.* v. *Federal Trade Commission,* 280 U.S. 291, 299 (1930).

the objective of assuring fair dealing by a seller with his customers could not be achieved unless the seller assumed that all direct customers in functional competition in the same geographic area buying products of like grade and quality within approximately the same period of time were in actual competition with one another in the distribution of such products (329 F. 2d at 709). This rationale, however, is not sufficient to justify a finding of violation against a *buyer*. An assumption which a seller may be required to make in determining the necessity of according proportional treatment among his customers is not necessarily an assumption which a buyer is capable of making in determining whether an allowance offered by a seller has been extended by that seller on proportionally equal terms to all customers. More definite proof must be required because the buyer does not even know the identity of the seller's other customers, much less the specific products which they buy.

For this reason, it was incumbent upon the Commission to trace the sale of goods of like grade and quality to the shelves of competing outlets in order to establish the existence of competition and to prove that Fred Meyer had knowledge of the circumstances. The Commission has done neither.

Furthermore, even if Fred Meyer had known the identity of other customers of the private label suppliers, this would not provide a basis for an inference that it knew that the products sold to such customers were of like grade and quality to those featured during the promotions. It cannot be inferred that different private label products are of like grade and quality without specific proof. To a large degree, however, such proof is absent (see *supra*, pp. 45-48, 53-54, 55-58).[56] It certainly cannot be inferred, therefore, that Fred Meyer had knowledge that

[56] The failure to produce material evidence which is available and which would be expected to be produced under the circumstances gives rise to a presumption that such evidence would be unfavorable or adverse to the party who withholds it. *Mammoth Oil Company* v. *United States*, 275 U.S. 13 (1927); *Kirby* v. *Tallmadge*, 160 U.S. 379 (1896).

goods of like grade and quality were sold to the allegedly disfavored customers.

Indeed, in view of the fact that every retailer who testified on the subject admitted that he had no knowledge of the grade and quality of private brand products sold by other retailers, the inference must be to the contrary. Thus, for example, Mr. Meier, Divisional Merchandise Manager of Lipman, Wolfe, testified:

> As a rule, I'm not too familiar with the competition in the community with regard to this product [Burlington hosiery sold under Lipman's "Waverly" brand] because we have it [the "Waverly" brand] exclusively, and I tend to my own business, rather than looking at what the other guy is doing (R. 447).

Likewise, there is no evidence which can support a finding that Fred Meyer knew or should have known the specific prices and allowances granted to allegedly disfavored customers and the Commission did not presume to find that Fred Meyer had *actual* knowledge. Rather, it merely refers to the fact that Fred Meyer maintained a "pretty close" personal contact with the broker representing Tri-Valley and Idaho Canning to support its inference that Fred Meyer knew or should have known the specific prices and allowances to allegedly disfavored customers. However, there is nothing which even suggests that this broker advised Fred Meyer concerning the specific prices or allowances to his other customers. Certainly, knowledge in the possession of a seller's broker cannot be attributed, by inference, to the buyer. It can be inferred, however, that neither brokers nor sellers travel about dispensing comparative price or allowance information to competing customers. Thus, the mere fact that Fred Meyer dealt with a broker cannot substitute for evidence which is lacking.

Moreover, the fact that Fred Meyer did not know the prices and allowances of other customers is corroborated

by testimony of other retailers that they did not possess such information.[57]

It must be concluded, therefore, that the Commission erred in finding that Fred Meyer maintained an "intelligence network" which served to inform it of prices and allowances offered and granted to the allegedly disfavored customers or which informed it of the fact, if indeed it was a fact, that those customers purchased, handled, or sold products of like grade and quality. For these reasons, both Counts I and II of the Complaint must be dismissed.

4. Fred Meyer Neither Knew Nor Had Reason to Know That the Allowances Granted By Philip Morris Were Not Available to Other Customers

In an effort to prove that Philip Morris Company failed to proportionalize its promotional allowances among all competing customers, the Commission relied upon the following testimony of Philip Morris' local sales representative:

> Q. Whereas if a competing customer of Fred Meyer wanted that type of an allowance, he would have to come to you and ask for it?
> A. *It's available to them.*
> Q. But do you make the offer, Mr. Eberling?
> A. No (R. 536; emphasis added).

This testimony means nothing more than that the local sales representative did not personally offer the allowances in question. He testified it was his practice to forward requests for promotional assistance to Philip Morris' New York office and that all the allowances in issue were avail-

[57] The Divisional Merchandise Manager of Lipman, Wolfe testified, for example, that he had no knowledge of the advertising and promotional allowances offered by Cannon Mills in 1956, 1957 and 1958 (R. 393). This corroborates fully the testimony of representatives of Fred Meyer that they, likewise, did not have knowledge of the allowances offered by suppliers to other customers (R. 363, 380-81, 691-92).

able to all customers either upon request or pursuant to an offering (R. 535-38). The Commission, however, failed to produce any witnesses or records from the New York office showing what offers of promotional assistance had been made by Philip Morris from that office.

Moreover, the Commission clearly erred in ruling that Fred Meyer knew or had reason to know that offers of promotional allowances, which were admittedly "available", had not been "affirmatively offered" to all competing customers by Philip Morris.

It would be highly unfair to make a buyer chargeable with knowledge that a seller has failed to undertake the additional step of extending an "affirmative offer" where, as here, the Commission can claim no more than that Philip Morris made its allowances "available" to all competing customers on proportionally equal terms but did not extend an "affirmative offer" in some instances to certain customers. Certainly, Fred Meyer cannot be held chargeable with knowledge under such circumstances.

Moreover, as pointed out *supra,* pp. 60-66, the alleged disfavored customers of Philip Morris in fact received very substantial promotional payments. However, the fragmentary evidence makes it impossible to determine whether the dollar amounts received by other customers were in fact proportional to the amounts received by Fred Meyer because there is no evidence as to comparative sales volumes from which such calculations can be made and because the relevant records relating to promotional payments by Philip Morris, kept in their New York office, were not produced.

Therefore, the allegations under Count II of the Complaint as they relate to Philip Morris must be dismissed.

VI. THE COMMISSION IS NOT AUTHORIZED TO PROCEED AGAINST A BUYER FOR THE ALLEGED INDUCEMENT AND RECEIPT OF DISCRIMINATORY PROMOTIONAL BENEFITS UNDER SECTION 5 OF THE FEDERAL TRADE COMMISSION ACT

The Commission erred in ruling that section 5 of the Federal Trade Commission Act, which contains a general prohibition against "unfair methods of competition", authorizes it to proceed against a buyer for the alleged inducement of a promotional payment which the seller fails to proportionalize in accordance with section 2(d) of the Clayton Act. While the Commission's authority to so proceed has thus far been sustained, over vigorous dissent, by the Second and District of Columbia Circuits, *The Grand Union Co.* v. *Federal Trade Commission,* 300 F.2d 92 (2d Cir. 1962); *American News Co.* v. *Federal Trade Commission,* 300 F.2d 104 (2d Cir. 1962); *Giant Food, Inc.* v. *Federal Trade Commission*, 307 F.2d 184 (D.C. Cir. 1962), the issue has not yet been finally determined. It is petitioners' contention that the persuasive arguments set forth in the dissenting opinions of Judge Moore and Commissioner Tait in *American News* and *Grand Union, supra,*[58] compel the conclusion that the Commission is not authorized to utilize section 5 against buyers.

In essence petitioners' contention, in the words of Judge Moore, is that the Commission, in assuming authority to proceed against a buyer under section 5 of the Federal Trade Commission Act has

> . . . arrogate[d] to itself the legislative powers of Congress whenever there appears a field which Congress has not covered but which the Commission believes should be covered by legislation of its own making. *Grand Union Co., supra,* at 101 (dissenting opinion).

Thus, while the Clayton Act contains *express* prohibitions against the unlawful inducement and receipt by a buyer of unjustified price discriminations and sham broker-

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[58] See 300 F. 2d at 101; 300 F. 2d at 112; and 57 F.T.C. at 426.

age payments, nowhere in the Act (or in any other Act) has Congress prohibited inducement of disproportionate promotional allowances. In short, under the Clayton Act Congress has given promotional payments a completely different status than payments which take the form of discriminations in price and brokerage.[59]

The Commission, while acknowledging that there is no express prohibition in the Clayton Act against inducement and receipt of discriminatory promotional payments, has held "that Congress intended to include the knowing inducement or receipt of a disproportionate allowance within the purview of section 2(f) and that its failure to do so was the result of an oversight." [60] *The Grand Union Co.,* 57 F.T.C. 382, 422 (1960). Therefore, the Commission arrogates to itself the authority to correct Congressional "oversight" under the guise of an expansive interpretation of section 5. However, the Supreme Court has declared that neither the Commission nor the courts should attempt to "supply what Congress has studiously omitted" from the Robinson-Patman amendments to the Clayton Act. *Federal Trade Commission* v. *Simplicity Pattern Co.,* 360 U.S. 55, 67 (1959).

This is especially true, the Supreme Court has clearly noted, in a case such as the instant one where the extension of jurisdiction sought by the Commission engenders conflict with the Sherman Act. Thus, in *Automatic Canteen,* the Court recognized that bargaining between buyers

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[59] Section 2(a) of the Act prohibits discriminations in price where the effect may be substantially to lessen competition and section 2(f) makes it unlawful for a person to induce or receive discriminations in price prohibited by section 2(a). Section 2(c) expressly makes it unlawful for any person to grant or receive discriminations in the form of sham brokerage payments and section 2(d) expressly prohibits the granting by a supplier of disproportionate promotional allowances. However, contrary to sections 2(a) and 2(c), there is no provision making unlawful the inducement and receipt of allowances prohibited under 2(d).

[60] As Judge Moore pointed out in *Grand Union, supra*: "The failure to include the buyer clearly could not have been inadvertent because the very purpose of the legislation was to curb the power of the mass buyer" (300 F.2d at 102; dissenting opinion).

and sellers is the essence of competition and strictly construed section 2(f), stating that the statute should not be interpreted as "... putting the buyer at his peril whenever he engages in price bargaining" because "[s]uch a reading must be rejected in view of the effect it might have on that sturdy bargaining between buyer and seller for which scope was presumably left in the areas of our economy not otherwise regulated" (346 U.S. at 73-74). This the Court did because of its "... duty to reconcile such interpretation ... with the broader antitrust policies that have been laid down by Congress," referring to the Sherman Act (346 U.S. at 74). Based on this premise, the Court went out of its way in *Automatic Canteen* to reject any easy standards for conviction under section 2(f) and read into the statute all of the seller's defenses under section 2(a). Such defenses, of course, are not available under 2(d), a *per se* section, and certainly, an attempted extension of the Commission's jurisdiction to hold buyers accountable for inducing violations of section 2(d) is fraught with greater inherent dangers than easy enforcement standards under section 2(f), which were rejected by the Court. Curtailment of "sturdy bargaining" between buyer and seller will surely result if the Commission is allowed to extend its jurisdiction, as it here asserts. This result, as pointed out by the Supreme Court, is not in harmony with "broader antitrust policies".

Furthermore, the Commission in its assumption of jurisdiction under section 5 of the Federal Trade Commission Act, ignores the fact that section 5 of that Act is intended to reach practices which have an actual or probable adverse effect upon competition. Section 2(d), however, is a *per se* section; *i.e.,* no finding of actual or potential injury to competition is required to sustain a finding of violation. The use of section 5 to prohibit the inducement of disproportionate promotional allowances thus runs contrary to existing precedents under section 5 which require (except in cases such as false advertising, price fixing, conspiracy to boycott, etc., where a *per se* rule applies) a showing of actual or probable injury to competi-

tion. *Federal Trade Commission* v. *Motion Picture Advertising Service Co.,* 344 U.S. 392, 394-95 (1953); *Fashion Originators Guild* v. *Federal Trade Commission,* 312 U.S. 457, 465 (1941); *Federal Trade Commission* v. *Keppel & Bros.,* 291 U.S. 304 (1934); *Federal Trade Commission* v. *Cement Institute,* 333 U.S. 683 (1948); *Federal Trade Commission* v. *Beech-Nut Packing Co.,* 257 U.S. 441 (1922).[61]

On repeated occasions the Supreme Court has reaffirmed these early decisions holding that an unfair method of competition is one which "destroys competition and estab-establishes monopoly."[62] Thus, if the Commission is to apply section 5 to a new business practice, it must make inquiry into, and a determination of, the "character" and "consequences" of the challenged practice, showing that it is "against public policy because of 'its dangerous tendency unduly to hinder competition or to create monopoly'." *Federal Trade Commission* v. *Beech-Nut Packing Co.*, 257 U.S. 441, 454 (1922).[63]

For the foregoing reasons, it must be concluded that the Commission is not authorized to proceed against a buyer under section 5 of the Federal Trade Commission Act and that Count II of the Complaint must be dismissed.

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61 The scope of section 5's prohibition against "unfair methods of competition" was first enunciated by the Supreme Court in 1920 in *Federal Trade Commission* v. *Gratz,* 253 U.S. 421, 427-28 (1920):

> The words "unfair method(s) of competition" are not defined by the statute, and their exact meaning is in dispute. It is for the courts, not the Commission, ultimately to determine, as matter of law, what they include. They are clearly inapplicable to practices never heretofore regarded as opposed to good morals because characterized by deception, bad faith, fraud, or oppression, or as against public policy *because of their dangerous tendency unduly to hinder competition or create monopoly.* The act was certainly not intended to fetter free and fair competition as commonly understood and practiced by honorable opponents in trade (emphasis added).

62 *Pan American World Airways, Inc.* v. *United States,* 371 U.S. 296, 307 (1963).

63 Applying the test of injury to competition established in *Gratz, Keppel, Motion Picture Advertising* and *Beech-Nut,* the Supreme Court has set aside Commission decisions and orders where there has been a failure to show the requisite adverse competitive effects. *Federal Trade Commission* v. *Curtis Publishing Co.,* 260 U.S. 568 (1923); *Federal Trade Commission* v. *Sinclair Refining Co.,* 261 U.S. 463 (1923).

VII. THE COMMISSION ERRED IN ISSUING AN ORDER TO CEASE AND DESIST AGAINST THE INDIVIDUAL PETITIONERS

The Commission's order to cease and desist, while designed to reach only certain *corporate* activities of the *corporate* petitioner, also applies by its terms to Mr. Fred G. Meyer and Mr. Earle A. Chiles, "individually and as officers of corporate respondent" (R. 57). Absent a showing of special circumstances indicating a likelihood that corporate petitioner may seek to evade the order issued, it was error for the Commission to include these individuals, as individuals, in the order. There has been no showing.

Corporate petitioner is a long-established and highly responsible company. It was organized in 1923 (R. 162), and owns and operates thirteen retail stores with sales in excess of $40 million annually (R. 13).

Mr. Fred G. Meyer holds no position other than Chairman of the Board, is a minority stockholder, (having only 38.35 percent of the 1,479,250 shares of common stock issued and outstanding (CX 363, pp. 3, 11)), and has nothing to do with the advertising and sales policies of the corporate petitioner (R. 464). Indeed, Mr. Meyer ceased activities in the Advertising and Sales Division approximately ten years ago, and is not even familiar with the operation of the coupon book program (R. 467).

Earle A. Chiles, President of Fred Meyer since 1955, is generally responsible for merchandising operations, but only at the policy-making level (R. 161-62. He owns only 14.37 percent of the company's outstanding common stock (CX 363, pp. 3, 11).

Ownership of a minority stock interest is no basis for including individually a corporate officer in an order. *Ostermoor & Co.* v. *Federal Trade Commission,* 16 F.2d 962 (2d Cir. 1927). Nor is an order against an individual warranted simply because he happens to be Chairman of the Board or a corporate officer. *Maryland Baking Co.,* 52 F.T.C. 1679, 1691 (1956).

Disregarding these precedents, the Commission merely

relies upon certain language in *Federal Trade Commission* v. *Standard Education Society,* 302 U.S. 112, 120 (1937), a false advertising case (R. 136-37). This reliance is misplaced. There is nothing in the present case which suggests that the individuals "acted with practically the same freedom as though no corporation had existed" or were "the actors" with respect to the alleged unlawful practice.

VIII. THE COMMISSION ERRED IN ISSUING AN ORDER TO CEASE AND DESIST IN TERMS WHICH BEAR NO REASONABLE RELATIONSHIP TO THE ALLEGEDLY UNLAWFUL PRACTICE

The Commission's all-encompassing order to cease and desist bears no reasonable relationship to the allegedly unlawful practices. The allegations of the complaint are limited, with only one minor exception, to Fred Meyer's coupon book program. But this program is not even mentioned in the order.

If any order is justified in this case, which petitioners deny, it must be directed solely against the allegedly illegal aspects of the coupon book program and must clearly advise petitioners of the practices they must discontinue. Only such an order can provide a basis for the Commission and the courts to readily determine questions of compliance or non-compliance.

A. The Section 2(f) Order

The 1959 Clayton Act Finality Act [64] made all Robinson-Patman Act orders final and enforceable in the same manner as Commission orders under the Federal Trade Commission Act,[65] *i.e.,* they become final and enforceable 60 days after their issuance in the absence of an appeal and a $5,000 fine is provided for each violation of a final order, or, in the event of a continuing violation, the penalty may be $5,000 per day of violation.

The new enforcement provisions of the Finality Act constitute a legislative modification of the rationale of the

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[64] 15 U.S.C. § 21.

[65] 15 U.S.C. § 45.

Ruberoid case,[66] in which the Supreme Court sanctioned the issuance of Robinson-Patman Act orders broadly drawn in terms of the generalities of the statute but in which the Court declined to order their enforcement. Now that such orders become final automatically, it is clearly necessary that they be framed in specific terms in the first instance. The intention of Congress to shift from the courts back to the Commission the task of formulating orders which are reasonably definitive is clearly evidenced by the legislative history of the Finality Act.[67]

In ruling upon the effect of the 1959 amendments upon the Commission's order-writing function, the Supreme Court held in *Federal Trade Commission* v. *Henry Broch & Co.,* 368 U.S. 360, 367-68 (1962):

> The severity of possible penalities prescribed by the amendments for violations of orders which have become final underlines the necessity for fashioning orders which are, at the outset, sufficiently clear and precise to avoid raising serious questions as to their meaning and application.[68]

The first decision in a Robinson-Patman case construing the Finality Act was *Swanee Paper Corp.* v. *Federal Trade Commission,* 291 F.2d 833 (2d Cir. 1961), which arose under section 2(d). There, the court ruled that ". . . there must be some relation between the facts found and the

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66 *Ruberoid Co.* v. *Federal Trade Commission,* 343 U.S. 470 (1952).

67 H. Rep. No. 580, "Finality of Clayton Act Orders, to Accompany S. 726", 86th Cong., 1st Sess. (1959), p. 6; S. Rep. No. 83, "Making Clayton Act Orders Final, To Accompany S. 726", 86th Cong. 1st Sess. (1959), p. 3; Hearings before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, U. S. Senate, 85th Cong., 2d Sess., pursuant to S. Res. 231 (1958), p. 31; Report of the Attorney General's National Committee to Study the Antitrust Laws (1955), p. 374; Hearings before the Antitrust Subcommittee (Subcommittee No. 5) of the Committee on the Judiciary, House of Representatives, 86th Cong., 1st Sess., on H.R. 432, H.R. 2977, H.R. 6049, and S. 726, Serial No. 3 (1959), p. 86; 105 Cong. Rec. 12735 (1959).

68 While the *Henry Broch* case was a proceeding under subsection 2(c) of the statute, the Court's rationale is equally applicable to proceeding under other subsections.

breadth of the order'' (*Id.* at 837), and ''. . . the order should be limited to the particular practice found to violate the statute'' (*Id.* at 838).

The Commission's policy since enactment of the 1959 amendments, as to the scope of Robinson-Patman Act orders, has often been wavering and inconsistent. In several cases, the Commission has attempted to relate the scope of the order, with some degree of reasonable precision, to the practice alleged to be unlawful. For example, in *The Quaker Oats Co.,* CCH Trade Reg. Rep., 1961-63 Transfer Binder, ¶ 15,858, at p. 20,649 (1962), the Commission properly restricted the scope of its 2(d) order to ''cat food and related products'' because the only product shown to have been involved in the promotional event held to be unlawful was cat food. For similar reasons, the Commission restricted its 2(d) order in *Vanity Fair Paper Mills, Inc.,* CCH Trade Reg. Rep., 1961-63 Transfer Binder, ¶ 15,796 (1962), to ''paper products.'' Likewise, in *Transogram Co.,* CCH Trade Reg. Rep., 1961-63 Transfer Binder, ¶ 16,080 (1962), the Commission's 2(d) order was restricted to the products shown to have been involved in the violation, namely ''Toy, game, or hobby products.''

Of possibly greater significance was the Commission's attempt in *Transogram* to define the specific services to which the order should apply. Thus, the order reached only the following specific services and facilities:

> . . . advertising or other publicity, furnished by or through a customer, in a toy catalogue, hand bill, circular, or any other printed publication serving the purpose of a buying guide, distributed . . . by such customer . . . (Final Order of the Commission, Sept. 19, 1962).

The Commission's more recent order in *All-Luminum Products, Inc.,* 3 CCH Trade Reg. Rep., ¶ 16,665 (1963), appears to conform even more closely with the Congressional objectives underlying the Clayton Act Finality Act. In addition to restricting the order to certain defined services and facilities, namely, catalogues or other buying

guides and trade shows, the order was restricted to payments made to the following classes of customers:

> (1) any wholesale customer of respondents whether or not such customer maintains an inventory of respondents' products, or
>
> (2) any mail-order distribution or catalogue house that is a customer of respondents.

The foregoing orders were issued against sellers under section 2(d) of the statute. It is obvious that the requirement of specificity in an order against a buyer should be even greater. This necessarily follows from the Commission's own ruling that section 2(d) "... is in itself a very narrow definition of an illegal trade practice" and "... covers a limited area in which forms of violations are like or related ..." *Vanity Fair Paper Mills, Inc.,* CCH Trade Reg. Rep., 1961-63 Transfer Binder, ¶ 15,796, at p. 20,610 (1962).

The broader scope of section 2(a) dictates, as the Commission indicated in *Vanity Fair, supra,* that orders issued thereunder must be strictly related to the specific practice alleged to be in violation of law and must not be framed in terms broadly encompassing the entire range of possible statutory violations. This is all the more true with respect to orders under section 2(f) where, in order to avoid a charge of violation, a buyer must assure that the prices charged by each of his suppliers are not illegally discriminatory.

The Commission's 2(f) order is also defective in that it prohibits the knowing inducement or knowing receipt of discrimination in price by "directly or indirectly" inducng or receiving a net price that is known, or should be known, to be below the net price at which products "of like grade and quality" are being sold to other purchasers where:

> (a) the seller is competing with any other seller for petitioners' business;
>
> (b) the petitioners are competing with other purchasers of the seller;

(c) the petitioners are competing with customers of other purchasers of the seller.

The nature of competition between Fred Meyer and other retail outlets is difficult to ascertain. The fact that petitioners might know that a competing retail outlet deals in a manufacturer's products of like grade and quality to those sold by them would provide no indication that the competing retailer actually purchased from the manufacturer. It may well have purchased the goods from a third party.

For these reasons, any order entered in this case must make it clear that no penalty for violation can attach unless the petitioners have actual knowledge of the competitive relationships affected by a price discrimination at either the primary or the secondary levels.

B. The Section 5 Order

Subsequent to the initial decision herein, the Second Circuit has twice held that orders under section 5 prohibiting the inducement or receipt of allegedly illegal promotional allowances must be framed in terms of ". . . the particular practice found to violate the statute." *Grand Union Co.* v. *Federal Trade Commission,* 300 F.2d 92, 100 (2d Cir. 1962); *American News Co.* v. *Federal Trade Commission,* 300 F.2d 104, 111 (2d Cir. 1962).

In *Grand Union,* the court ruled that the Commission's discretion ". . . does not permit an injunction of all violations of the statute just because a single violation has been found." Ruling that the order must be limited to the particular practice found to violate the statute, the court held that, since Grand Union had received as well as solicited payments, the order must be limited to ". . . a prohibition of either knowing receipt or knowing inducement and receipt" (300 F.2d at 100-101). A similar ruling was made in *American News, supra.*

In the present case, instead of being related to the knowing receipt of disproportionate promotional payments, the order extends to the ". . . [i]nducing, receiving or con-

tracting for the receipt of anything of value . . .''. Likewise, although the services and facilities furnished by petitioners were limited to a single annual coupon book program, the order extends to unrelated ''. . . advertising or any other services or facilities . . .''. Furthermore, the practice in the present case is narrowly confined to a promotional program involving the ''offering for sale'' of only specific products manufactured by particular suppliers, but the order extends to ''processing'' and ''handling'', as well as the ''offering for sale'' of products. In addition, the order extends to *all* products involved in respondents' promotional activities, *i.e.,* thousands of products, and is not limited to the specific products involved in the Commission's findings of alleged violation as was the order in the *Quaker Oats* case, *supra,* p. 98.

From the foregoing, it is obvious that the order, if any order is appropriate, must be modified so as to conform to the particular practice involved in this case.

The section 5 order must further be modified insofar as it applies to the inducement of promotional allowances which Fred Meyer knows or should know are not offered or otherwise made available to its competitors ''including other customers who resell to purchasers who compete'' with Fred Meyer at the retail level (R. 58). This language amounts to a categorical declaration that wholesale customers of a supplier are entitled to promotional benefits equal to those granted retail customers. However, as this Court has held, section 2(d) does not envision this result *unless* there exists an indirect customer relationship between the supplier and the customers of the wholesaler (see *supra,* pp. 30-31).

In *Grand Union Co.* v. *Federal Trade Commission,* 300 F.2d 92, 100 (2d Cir. 1962), the court pointed out:

> Unlike the seller, the buyer has no control over those payments—he cannot insure that they are ''proportionalized''. . . . It would be a harsh burden to hold that any buyer who induces or receives a payment later found to be disproportionate has engaged thereby in unfair competition.

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> Unlike the seller, the buyer has no control over those payments—he cannot insure that they are ''proportionalized''. . . . It would be a harsh burden to hold that any buyer who induces or receives a payment later found to be disproportionate has engaged thereby in unfair competition.

These difficulties are compounded when the order's scope is broadened, as here, to require that payments for services and facilities offered to competing retail customers be extended to wholesaler customers of the supplier. A retailer, such as Fred Meyer, does not know, and has no way of ascertaining, the retailers to whom such wholesalers sell, nor what retailer customers of particular wholesalers compete with it. Petitioners do not know, and have no way of determining, the grade and quality of the products sold by such wholesalers or their commercial origin. They do not know, and have no way of determining, the allowances offered such wholesalers by manufacturers. In addition, petitioners are completely unequipped to determine whether particular allowances offered by suppliers to wholesalers are accorded on proportionally equal terms, and whether they are suitable, as a practical matter, to the needs of such wholesalers. For these reasons, the Commission's extension of the order to require proportionalization among wholesalers and retailers imposes a harsh and impossible burden upon petitioners which, in addition to being novel, is unfair, beyond the issues delineated by the complaint and beyond the Commission's discretionary authority. The words "including other customers who resell to purchasers who compete with respondents in the resale of such suppliers products" must, therefore, be stricken from the order if it is found that any order is appropriate.

CONCLUSION

For all of the foregoing reasons, petitioners respectfully submit that the Opinion and Order of the Commission must be set aside and the complaint dismissed.

Respectfully submitted,

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Dated: November 2, 1964

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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Attorney for Petitioners

APPENDIX

APPENDIX

List of Exhibits

Commission Exhibits	*For Identification* [1]	*In Evidence* [1]
1 (pp. 33, 37, 61)	R. 19	R. 32
2 A-C	R. 19	R. 32
3	R. 20	R. 32
4 (pp. 34, 39, 60, 61, 64)	R. 21	R. 32
5 A-B	R. 21	R. 32
6	R. 22	R. 32
7	R. 16	R. 32
8	R. 23	R. 32
9 B, C, D	R. 24	R. 32
11	R. 8	R. 42
12 A-B	R. 196, 303	R. 199, 303
13	R. 25	R. 32
14	R. 25	R. 32
16	R. 17	R. 32
17	R. 26	R. 32
18	R. 33	R. 36
19	R. 33	R. 36
21	R. 48	R. 48
22	R. 49	R. 50
23 A-B	R. 51	R. 54
24 (pp. 34, 59, 62)	R. 54	R. 54
25	R. 55	R. 55
26	R. 64	R. 65
27	R. 65	R. 66
28	R. 66	R. 67
29	R. 67	R. 69
30	R. 68	R. 69
31	R. 72	R. 74
32	R. 74	R. 83
33	R. 74	R. 83
34	R. 74	R. 83
35	R. 74	R. 83
36	R. 74	R. 83

[1] Page references are to the original transcript of record.

Commission Exhibits	*For Identification*	*In Evidence*
37	R. 74	R. 83
39	R. 84	R. 84
40	R. 84	R. 85
41	R. 85	R. 86
42 A-B	R. 104	R. 109
43 A-B	R. 104	R. 109
44	R. 104	R. 109
45	R. 104	R. 109
46	R. 104	R. 109
47	R. 104	R. 109
48	R. 122	R. 124
49	R. 122	R. 124
50	R. 122	R. 124
51	R. 122	R. 124
52	R. 122	R. 124
53	R. 122	R. 124
54	R. 122	R. 124
55	R. 122	R. 124
56	R. 122	R. 124
57	R. 122	R. 124
58	R. 122	R. 124
59	R. 122	R. 124
60	R. 122	R. 124
61	R. 122	R. 124
62	R. 122	R. 124
63	R. 122	R. 124
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No. 18903

In the United States Court of Appeals for the Ninth Circuit

FRED MEYER, INC., a corporation, and FRED G. MEYER and EARLE A. CHILES, individually and as officers of said corporation, PETITIONERS

v.

FEDERAL TRADE COMMISSION, RESPONDENT

On Petition to Review an Order of the Federal Trade Commission

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BRIEF AND APPENDIX FOR RESPONDENT

FILED

MAR 15 1965

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In the United States Court of Appeals for the Ninth Circuit

No. 18903

FRED MEYER, INC., a corporation, and FRED G. MEYER and EARLE A. CHILES, individually and as officers of said corporation, PETITIONERS

v.

FEDERAL TRADE COMMISSION, RESPONDENT

On Petition to Review an Order of the Federal Trade Commission

---

BRIEF FOR RESPONDENT

This case comes before the Court on a petition to review an order to cease and desist issued by the Federal Trade Commission at the conclusion of an administrative proceeding in which the Commission determined that petitioners Fred Meyer, Inc., a corporation owning and operating a chain of retail grocery supermarkets, and Fred G. Meyer and Earle A. Chiles, two of its officers, have violated section 2(f) of the Clayton Act, as amended by the Robinson-Patman Act, 49 Stat 1527; 15 U.S.C. 13(f), by knowingly inducing from certain of their suppliers discriminatory prices prohibited by section 2(a) of that Act, 49 Stat. 1526; 15 U.S.C. 13(a), and violated

section 5(a)(1) of the Federal Trade Commission Act, 66 Stat. 632, 15 U.S.C. 45(a)(1), by knowingly inducing from those suppliers discriminatory promotional allowances prohibited by section 2(d) of the amended Clayton Act, 49 Stat. 1527; 15 U.S.C. 13(d).[1]

JURISDICTION

The Commission had jurisdiction of the petitioners and of the subject matter of the administrative proceeding by virtue of section 11(a) of the Clayton Act, 73 Stat. 243, 15 U.S.C. 21(a), and section 5(b) of the Federal Trade Commission Act, 66 Stat. 632, 15 U.S.C. 45(b); and by its issuance of a complaint against petitioners pursuant to those statutes (R. 3-11).[2] This Court has jurisdiction of the parties and subject matter of this review by virtue of section 11(c) of the Clayton Act, 73 Stat. 243, 15 U.S.C. 21(c), and section 5(c) of the Federal Trade Commission Act, 52 Stat. 112, 15 U.S.C. 45(c); by petitioners' timely filing with this Court of a petition to review the Commission's order (R. 707); and by virtue of the Commission's findings (undisputed on this review) to the effect that petitioner Fred Meyer, Inc., is a corporation organized and doing business under the laws of the State of Oregon, with its principal office and place of business in Portland, Oregon (R. 26), that petitioners Fred G. Meyer and Earle A. Chiles are officers of the corporation and maintain offices at the same address (R. 26), and that the corporation does business in and around Portland, Oregon (R. 27).

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[1] Pertinent portions of these and other statutory provisions are printed in appendix "A" to this brief.

[2] Reference is to the record as printed in this Court.

COUNTERSTATEMENT OF THE CASE

We are not able to accept petitioners' statement of the case, because it does not present the questions involved in this review nor show how they are raised by the events of record, because it misstates some and omits other facts essential to decision of the issues petitioners argue, and because it includes, as supposedly established and uncontested facts, what actually are contentions petitioners urged before the Commission and the Commission rejected in favor of findings to the contrary.

In the following statement we have attempted to recount the events of the administrative proceeding which led to this review, summarizing the nature of the essential findings and rulings made by the Commission, and identifying those as to which petitioners' arguments appear to raise issues requiring decision here.[3]

Proceedings Before the Commission

The administrative proceeding was instituted on May 15, 1959, by issuance of a complaint charging petitioners (Count I, R. 3-7) with violating section 2(f) of the amended Clayton Act, 49 Stat. 1527, 15 U.S.C. 13(f),[4] and (Count II, R. 7-9) with violating section 5 of the Federal Trade Commission Act, 66 Stat. 632, 15 U.S.C. 45.[5]

Petitioners' answer (R. 12-17) admitted certain facts but denied the essential allegations of the complaint.

[3]Petitioners' specifications of alleged errors does not specify any particular finding as erroneous, asserting only that certain holds are erroneous "as a matter of fact and law," and that "none of the conclusory findings of violation" are supported by evidence (Brief 7). We have, therefore, attempted to identify from petitioners' arguments the findings and rulings with which they desire to take issue.

[4] Apdx A, p. 1b.

[5] Apdx A, p. 1b.

Extensive hearings were held before two successive hearing examiners in 1959, 1960, and 1962, after which proposed findings and briefs were submitted, and the second examiner, on January 23, 1962, issued an initial decision (R. 18-55) containing conclusory findings, his opinion that petitioners' practices violate the statutes as alleged, and a proposed order to cease and desist.

Petitioners appealed to the Commission, which considered the matter *de novo* on the record, briefs, and oral argument, and on March 29, 1963, issued its opinion (R. 59-142) containing its own findings and rulings supplementing and modifying those in the initial decision. It also issued an accompanying order (R. 56-58) containing a proposed order to cease and desist different from the examiner's, and providing for the receipt from petitioners of objections thereto.[6]

After receipt and consideration of petitioners' objections the Commission on July 9, 1963, issued an opinion thereon (R. 148-57), accompanied by a final order containing the order to cease and desist as finally adopted.[7]

Petitioners do not argue here that any procedural errors occurred in the administrative proceeding.

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[6] The opinion was by Chairman Dixon. Commissioner McIntyre concurred, Commissioner Anderson concurred completely in the decision on the section 2(f) count and in the result on the section 5 count, Commissioner Elman concurred in the result on the 2(f) count and in the decision as to violation on the section 5 count and dissented as to the terms of the order on the latter count, and Commissioner Higginbotham did not participate because the case was argued before he joined the Commission (R. 58, 142-47).

[7] The final order was inadvertently omitted from the printed record in this Court, and is therefore reproduced in appendix "B" to this brief.

As before, Commissioner Elman dissented to the decision as to the form of the order on the section 5 count and Commissioner Higginbotham did not participate.

The Findings and Rulings of the Commission

The Commission found that Fred Meyer, Inc., is an Oregon corporation which operates 13 retail supermarkets in and around Portland, Oregon, selling grocery products, drugs, sundries, and a limited line of clothing, that its 1957 sales exceeded forty million dollars, and that it claims to sell one-fourth of all food sold at retail in that area, to be the second largest seller of all goods in that area, to sell to 75% of Oregon's population, and to have one supermarket in every neighborhood in Portland (R. 60). It found that Fred G. Meyer and Earle A. Chiles are respectively Chairman of the Board and President of the corporation and are the principal owners of its common stock (R. 61), that the corporation is but the "*alter ego*" of those two individuals, that they and their immediate families own virtually all of its voting common stock (R. 136), that they knew about and authorized the practices found unlawful, that they set the corporation's advertising policy and reviewed its advertising practices, that Mr. Meyer had been in the industry for 50 years (R. 137), that they could not have occupied their positions for the 25 years during which those practices were used without having been aware of and personally approving them, and that they are the persons with the actual power to see that the order prohibiting those practices is carried out (R. 138). Principally based upon those facts, the Commission concluded that its order to cease and desist should apply to those individuals, and issued its order accordingly (Apdx B). Petitioners have not specified any of these findings as error, nor have they argued that any of them is not supported by substantial evidence. However, they specify the order's inclusion of the individuals as error (Brief 8, sp. 6), and in their argument on that issue (Brief 95-96) they assert several purported facts contrary to certain of those findings. We maintain (*infra*, pp. 31-34, 91-92) that in an appellate review such as this the findings made below are conclusive unless shown by petitioners to be unsupported by substan-

tial evidence, that the findings rather than petitioners' assertions therefore establish the relevant facts, and that in the circumstances of this case the Commission did not abuse its discretion in making its order applicable to those individuals.

The Commission found that petitioners, in connection with their purchases in interstate commerce of merchandise for resale at retail, have induced and received preferential treatment from their suppliers, in the forms of discriminatory prices on such merchandise and discriminatory payments for services rendered the suppliers by the corporation. Most of these were received under the corporation's annual "coupon book" promotion, which petitioners began in about 1936 and have used every year since. Under that plan they sell to consumer-customers, at a price of ten cents each, 72-page coupon books. Each page features a single product, and states the price at which their stores have regularly been selling it, the specially reduced "coupon" price, the difference between those prices as the amount the coupon is worth when presented in purchasing that product, and other advertising statements. The period during which the coupons may be redeemed begins always in September, lasts for exactly four weeks, and ends in October. A typical coupon featured canned peaches, regularly 31 cents each, and entitled the customer presenting it to obtain three cans by paying for two at the regular price, thus saving 31 cents. The cover of the 1957 book states that the use of all 72 coupons can result in total savings of over $54. Customers bought $13,870 worth of books (138,700) in 1959 and $12,127 worth (121,270) in 1958 (R. 61-64). Petitioners have not specified any of these findings as erroneous, and do not argue that any of them is not supported by substantial evidence.

The Commission found (R. 64-65) that the amounts received by petitioners from the sale of the coupon books was not enough to cover the costs of publishing, distributing, and promoting them. It found that those costs

were borne by the participating suppliers, each of which had in effect bought a single page in the book at a price of $350, and paid for it in cash, free goods, or some other mutually acceptable form, so that each year petitioners have received approximately $25,200 from their suppliers for publication of the coupon books. The Commission considered and explicitly rejected (R. 65, note 10) petitioners' arguments that only the *cash* payments they received were for services rendered, and that the payments in kind should not be counted. The Commission found that at least $350 per page, in cash, free goods, or otherwise, was received from each participating supplier as compensation for the coupon book page. It found that petitioners' actual costs, including art work, typesetting, printing, distribution, sale, and advertising were $23,318 in 1956 and $23,406 in 1957, so that the amounts received from sale of the coupon books to consumers was net profit on that part of the operation. Principally based upon these facts the Commission concluded that the $350 paid by each participating supplier was a payment "as compensation or in consideration for * * * services or facilities furnished by * * * such customer in connection with the * * * sale, or offering for sale" of that supplier's product, cognizable under section 2(d) of the amended Clayton Act (R. 64-65). Petitioners do not specify any of these findings or the conclusion as error, or argue that any of them is not supported by substantial evidence.

The Commission found (R. 66-69) that in addition to the $350 for each coupon page, petitioners solicited and received from each supplier additional amounts, in cash or reduced prices or in kind, to cover the reduced retail prices of the merchandise sold to consumers redeeming the coupons. The Commission found that those additional amounts were solicited and received as, and actually were, price reductions made for the purpose of enabling petitioners to resell the merchandise at reduced prices, rather than constituting compensation to petitioners for services to the suppliers. The Commission found that the evidence showed that petitioners' assertions to the con-

trary were not true (R. 69-74). Based upon those and additional detailed findings the Commission concluded that those amounts were price discriminations cognizable under sections 2(a) and 2(f) of the amended Clayton Act (R. 69-75). Petitioners do not specify any of those findings as erroneous, nor do they argue that any of them is without substantial evidentiary support. However, they specify the conclusion as error (Brief 7, sp. 1), and in their statement of the case they erroneously state (Brief 3), as a supposedly established fact, that all payments received from and made by the participating suppliers were designed and contemplated to constitute reimbursement to Fred Meyer for the furnishing of promotional services and facilities, and argue (Brief 16-26) that, therefore, the granting and receiving of the payments cannot be violations of sections 2(a) and 2(f). We contend (*infra*, pp. 31-34, 77-80) that petitioners' erroneous assertion as to the nature of the finding raises no issue as to its validity, but that in any event the Commission's conclusion is properly supported by the facts.

The Commission found that Tri-Valley Packing Association was one of the suppliers participating in the 1957 sale, that it contracted to pay and paid $350 for a coupon page on which customers were offered its peaches at three cans for the price of two, and contracted to and did replace the "free" cans of its peaches which petitioners' customers obtained by redeeming the coupons. Petitioners invoiced Tri-Valley $350 for the page and $4,814 for 20,-750 coupons (at the wholesale price of $.232 each), totalling $5,164, which Tri-Valley, pursuant to its contract, paid by shipping to petitioners, free of charge, $5,164 worth of peaches (R. 66-68). The Commission found that Idaho Canning, another supplier, participated in the same manner, paying $350 for a page in the 1957 book, plus $2,585.41 for 21,367 coupons redeemed at $.121, a total of $2,935.41, that it paid this amount in the form of free goods (canned corn), and that its coupon had enabled the customers to obtain three cans for the price

of two (R. 68). The Commission found (R. 68-69) that Cannon Mills participated in the 1956 sale by reducing its price to petitioners on fingertip towels from $1.65 per dozen to $1.55, for a total reduction of $750, and that its coupon offered the towels at seven for $1.00, instead of the regular price of $.23 each. It found (R. 69) that Burlington Industries participated in 1957 and 1958, reducing the prices of its nylon hose by amounts ranging from $.50 to $.94 per dozen, which aggregated $1,700 in 1957 and $1,800 in 1958. Petitioners do not specify any of these findings as erroneous, nor argue that any of them is not supported by substantial evidence.

The Commission found that in addition to the preferential treatment petitioners received under the annual coupon-book program, they also received certain payments from one supplier, Philip Morris, Inc., as consideration for their performance of certain promotional services for it in connection with their resale of its products (R. 75-80). The Commission found (R. 76-79) that although both petitioners and two other contemporaneous customers of Philip Morris (Oregon Piggly Wiggly Company and United Grocers, Inc.) received payments under its regular promotional allowance program (in which allowances were proportionalized to volume of purchases), the payments in question were not a part of that program, but were "special deals" in which flat, unproportionalized payments were made to and received by petitioners in addition to those they received under the regular program. The Commission found that those "special deals" were, by their very nature, incapable of being offered to competitors on proportionally equal terms, since they were flat payments, not quantitatively related to volume of purchase or any other measureable factor in the buyer-seller relationship (R. 79-82). Petitioners do not specify any of those findings as error and do not argue that any of them is not supported by substantial evidence. They argue, however (Brief 62-66), that despite those facts the Commission should not have found an absence of proportionally equal payments. We contend (*infra*, pp. 53-

57) that the Commission's determination is correct. The Commission also found (R. 79) that no such special deals were paid to, or made available to, the suppliers' other customers. Petitioners do not specify that finding as error, but argue (Brief 89-90) that the evidence does not support it. We contend (*infra*, pp. 54-57) that the finding is supported by substantial evidence.

The Commission found (R. 82-83) that the coupon-book allowances received by petitioners also were not made available to four other Portland buyers who bought the same products and resold them in that area: (1) Hudson House, (2) Wadhams & Co., (3) Lipman, Wolfe & Co., and (4) Roberts Brothers. It found that Hudson House is both a wholesaler and retailer and that it bought canned peaches from Tri-Valley Packing and canned corn from Idaho Canning (R. 82-83), that it owns three Portland retail grocery stores outright, and its controlling stockholder also owns the controlling stock of Oregon Piggly Wiggly, the retail grocery chain mentioned above (R. 85, n. 34). It found (R. 83) that Wadhams & Co. is a Portland wholesaler which bought canned corn from Idaho Canning, that Lipman, Wolfe & Co. is a Portland department store which bought nylon hose from Burlington Industries, and that Roberts Brothers is a Portland department store which bought fingertip towels from Cannon Mills. It found that each of those firms bought the goods in question during the periods when petitioners carried on the particular coupon-book sales but received from the suppliers no offer of any promotional allowances or payments during those periods (R. 83). Petitioners do not specify any of these findings as error, nor argue that any of them is not supported by substantial evidence.

The Commission concluded (R. 84) that all six of those buyers competed with petitioners in the "distribution" of the products in question, within the meaning of section 2(d) of the Clayton Act. It found (R. 84) that Roberts Brothers bought Cannon towels during the period of the

coupon-book sales and resold them at retail in competition with petitioners. It found that Lipman, Wolfe & Co. did the same with respect to nylon hose bought from Burlington Industries. It found (R. 84-85) that retail stores of Piggly Wiggly and United Grocers resold Philip Morris products in direct competition with petitioners' retail stores. It found (R. 85, n. 34) that United Grocers is a cooperative nonprofit buying organization owned by some 300 retail-grocer members and thus is not a wholesaler, and that Hudson House, although primarily a wholesaler, also carries on a substantial retailing business. Based primarily on these findings the Commission concluded that those customers of the suppliers, in purchasing the relevant products and commodities from the discriminating suppliers at the same time, handling them, and reselling them either at wholesale or at retail, were thereby "customers competing in the distribution of such products or commodities," within the intent and meaning of that language in section 2(d) of the amended Clayton Act. Petitioners do not specify any of those findings as error, nor argue that any of them is not supported by substantial evidence. However, they assert (Brief 27-28) that both Hudson House and United Grocers acted exclusively as wholesale dealers in their distribution of the commodities involved in this case. We contend (*infra*, p. 57, n. 19) that the Commission's ruling that United Grocers is a retailer, is entirely supported by the unchallenged findings. In addition, petitioners specify as purported error an incorrect version of the Commission's conclusion as to the suppliers' 2(d) violations (Brief 7, sp. 2), and argue (Brief 28-37) that where the recipient of a discriminatory payment or allowance from suppliers is the owner of retail stores, wholesalers selling to other retailers cannot, as a matter of law, be considered "other customers competing in the distribution" of the products concerned, within the protection of section 2(d). We contend (*infra*, pp. 57-66) that the Commission's contrary ruling is correct.

With respect to the suppliers' sales of Tri-Valley peaches and Idaho canned corn, the Commission found (R. 93-94) that the cans sold to Hudson House and Wadhams were packed under the buyers' private labels, that those buyers also bought from other suppliers peaches and corn packed under the same labels, with which the cans bought from Tri-Valley and Idaho Canning were commingled, and that although cans of those products bearing those labels appeared on the shelves of retailers for resale to consumers in competition with petitioners' retail stores, it was not possible to trace particular cans from Tri-Valley and Idaho Canning all the way to shelves of particular stores. The Commission found (R. 94) that the possibility that, despite the commingling, all the cans purchased from those two suppliers found their way by chance to other areas, is too remove for consideration. On the basis of these facts the Commission concluded (R. 95) that direct competition in the resale of those supplies' products existed between petitioners' retail stores and the retailer-customers of Hudson House and Wadhams & Co. Petitioners do not specify any of those findings as error, nor do they argue that any of them is not supported by substantial evidence. However, they argue (Brief 58-61) that competition cannot properly be found unless the evidence traces specific shipments from the discriminating suppliers to specific competing retailers. We maintain (*infra*, pp. 43-47) that such explicit tracing is not necessary, and the Commission's conclusion is properly supported by the facts found.

The Commission concluded (R. 95-96) that the products purchased by petitioners upon which they received the discriminations in prices and allowances were of like grade and quality to those the suppliers contemporaneously sold to those other customers designated above. In reaching that conclusion it found (R. 96) that the suppliers' descriptions and identifying data on each of the products were identical, held that this was sufficient to establish, *prima facie*, that the products were of like grade and quality, and pointed out that petitioners had

presented no evidence tending to show the contrary. It found that the mere fact that the goods bore the different private brands of the purchasers was not enough to rebut the inference of identity, and that the independent retailers who competed with petitioners had no doubt that the products were of like grade and quality. Petitioners do not specify as error that conclusion or any of those findings; however, they argue (Brief 46-48, 53-54, 56-58) that the evidence, although showing identity of manufacturers' identifying and grade designations, does not sufficiently establish that the products they purchased from Burlington Industries, Cannon Mills, and Tri-Valley were of like grade and quality to those purchased by the other customers involved in this case. We maintain (*infra*, pp. 40-43, 47-48, 49-50, 52) that the Commission's conclusion is properly supported by substantial evidence.

The Commission found (R. 97-100) that Hudson House did not receive the 33⅓% price reduction on Tri-Valley's canned peaches (aggregating $4,814) which petitioners received during the one-month period of their 1957 coupon-book sale, that neither Hudson House nor Wadhams & Co. received the 33⅓% price reduction (aggregating $2,-585.41) on Idaho Canning's corn during the same period, that Roberts Brothers did not receive the $.10 per dozen price reduction (aggregating $400) on Cannon Mills' fingertip towels which petitioners received for those bought for their 1956 coupon-book sale, and that Lipman, Wolfe & Co. did not receive the $.50 to $.94 per dozen price reductions on Burlington Industries' nylon hose which petitioners received during the 1957 and 1958 sales (aggregating $1,350 in 1957 and $1,450 in 1958). It based these findings on the suppliers' invoices showing the prices charged petitioners and the other customers, and testimony of a broker, the unfavored customers, and petitioners (R. 98-99). Petitioners do not specify any of those findings as error, nor argue that any of them is not supported by substantial evidence.

The Commission concluded (R. 100-103) that the effect of those price discriminations may be to injure competi-

tion with petitioners. It based that conclusion upon findings that competition in the food industry is keen, that the average retail grocery store carries from 2,500 to 6,000 separate items, that a price differential of one-half of one percent will swing a retailer from one supplier to another, that the net profit of some retailers is as low as 2%, that the profit margin at the wholesale level is about 2%, that the 33⅓% price concessions petitioners received from Tri-Valley and Idaho Canning and passed on to their customers resulted in retail prices below the prices at which other retailers bought those items from the nonfavored wholesalers, and that a price differential of one cent will switch some consumers from one grocery to another. It found (R. 102) that canned peaches and corn were the two fastest moving items in their respective lines (canned fruits and canned vegetables) so that price differentials on them were particularly significant because they attract customers who buy other products also, thereby magnifying the effect of the discrimination. It also found (R. 103) that while petitioners sold Burlington Industries' nylon hose at about 66 cents per pair, one of the nonfavored department stores paid about 64 cents per pair F.O.B. the factory for the same hose at the same time. Petitioners do not specify that conclusion or any of those findings as error, nor argue that any of them is not supported by substantial evidence. They assert, however (Brief 78-79), that the conclusion is wrong; we contend (*infra*, pp. 80-82) that it is a permissible inference, properly supported by the undisputed findings.

The Commission concluded (R. 103-36) that petitioners were aware that the price concessions and promotional payments they induced were discriminatory and not justified by any of the defenses which might have been available to the sellers. Petitioners specify that conclusion as error, and argue (Brief 66-90) that it is not supported by substantial evidence. We contend (*infra*, pp. 67-74, 77-91) that the conclusion is properly supported by the facts found by the Commission (summarized immediately be-

low), and that each of those findings with which petitioners appear to take issue is supported by substantial evidence.

The Commission based that conclusion upon findings, *inter alia*, that petitioners took the most vigorous steps to gather trade information (including monitoring newspaper advertising, "shopping" competing stores, checking competitors' prices, studying market conditions to see that prices they pay were "right," by reviewing suppliers' price bulletins, and by personal contact with brokers), that petitioners relied on brokers for price information, that the broker here concerned was familiar with suppliers' prices and notified petitioners of them, and that prices are a matter of general trade knowledge. It found (R. 110-11) that petitioners could not have been unaware that the other stores here involved were also selling the suppliers' same products. With respect to the participation by Idaho Canning in the 1957 sale, the Commission found (R. 113-16) that petitioners first approached that supplier about the matter during a convention in January of 1957, at which time Idaho did not decide whether or not to participate, and that no contract was signed, no agreement was reached, and nothing was done or said by Idaho to lead petitioners to believe that it was agreeing to participate. That was the last Idaho heard of the matter until the fall of 1957, when it learned that a page in petitioners' 1957 coupon book had featured three cans of Idaho's corn for the price of two, and it received from petitioners an invoice stating it owed them a total of $2,935.41 ($350 for the page and $2,585.41 for 21,367 coupons redeemed at $.121). It denied the invoice and returned it to Fred Meyer, Inc. Petitioners continued to buy from Idaho, and subsequently deducted the amount of $2,935.41 from one of Idaho's invoices. Idaho protested, and petitioners returned the money to Idaho, but a few months later Idaho yielded and shipped petitioners $2,935.41 worth of free goods, in order to satisfy petitioners' claims (R. 113-14). The Commission also found (R. 119-

20) that the payments and price concessions petitioners received in the coupon-book promotions were granted under agreements, formulated by petitioners, containing a provision that the supplier's "Offer Must Be Exclusive at Fred Meyer During the 4 Week Period," which constituted an agreement that during that particular four-week period the supplier would not participate in a similar program of another buyer, so that petitioners not only knew they were obtaining discriminatory favors, but were affirmatively requiring them. The Commission held (R. 117-18) that petitioners had more than enough information to put upon them the duty of making inquiry as to whether or not the suppliers were making the promotional payments available to other buyers. Petitioners do not specify as error any of those findings, nor argue that any of them are unsupported by substantial evidence. However, they argue (Brief 82-83) that the evidence does not show they required that the sellers' offers to them be exclusive during the periods of the promotions, nor (Brief 85-90) that they knew or had reason to know about the suppliers' treatment of other buyers with respect to prices and allowances, or that those buyers were purchasing products of like grade and quality. We contend (*infra*, pp. 67-73) that the Commission's findings to the contrary are supported by substantial evidence and therefore are conclusive. They also assert (Brief 69) that the Commission did not find and there is no evidence to support a finding that they exercised coercion on the suppliers; we contend (*infra*, p. 82, n. 34) that the undisputed findings summarized above concerning Idaho Canning show coercion.

The Commission held (R. 120-25) that even if the suppliers had offered to pay other buyers for some other kind of promotion during the same four-week period, or for the same kind during some other period, such offers would not have been upon "proportionally equal terms," within the requirement of section 2(d) as to simultaneity and likeness of benefits. Petitioners do not specify either of

those rulings as error, and do not argue that they are incorrect.

The Commission concluded (R. 130-36) that the sellers' price discriminations were not cost justified (under the proviso in section 2(a)), and that petitioners knew or should have known that fact.[8] It found (R. 131-32) that none of the four suppliers grant quantity discounts, that during eleven months of the year petitioners pay the same prices to those sellers as do other buyers, being unable to induce price discriminations during those months despite purchasing in larger quantities than their competitors. It found (R. 132-33) that the increase in petitioners' volume of purchases for the four-week period was incapable of producing sufficient savings, and held that it would be anomolous to permit a buyer who receives a large price discrimination and uses it to increase his sales volume, to claim the increased volume as causal justification for the discrimination. It found (R. 133) that if the nonfavored buyers had also received a 33⅓% price cut they too would doubtless have increased their sales and therefore their purchases from the suppliers. It found (R. 133-34) that every feature of petitioners' purchasing from the four suppliers in question remained the same during the promotion as during the rest of the year, and that the only possible saving suggested—on the cost of labeling Idaho corn with private labels—could not amount to one-third of the price of the can and contents. Petitioners do not specify that conclusion or any of those findings as error. They argue, however (R. 73-78), that the evidence does not establish that the discriminations were not cost-justified, or that they were so aware. We contend (*infra*, pp. 82-91), that the findings with which petitioners appear to take issue are supported by sub-

[8] Section 2(a) contains a proviso that nothing herein "shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered."

stantial evidence, and that the facts found properly support the Commission's conclusion.

The Commission found (R. 139) that the violations by petitioners involved vastly more products than the five in the instances specifically found unlawful, which were merely illustrative of petitioners' practices. It found that the coupon-book promotions have involved no fewer than 72 products each year for more than 25 years, and the same suppliers do not participate every year. It found (R. 139) that petitioners do not confine their solicitation of suppliers to particular products or classes of products, so that any of the many thousands of products petitioners sell can be featured in the coupon-book sales. The Commission therefore concluded (R. 139) that the public interest requires that its order to cease and desist cover all products petitioners retail. Petitioners do not specify any of those findings or that conclusion as error, nor argue that any of them is not supported by substantial evidence.

In conclusion the Commission adopted (R. 141) the hearing examiner's decision that petitioners have violated section 2(f) of the amended Clayton Act by knowingly inducing and receiving price discriminations violative of section 2(a) of that Act, and have violated section 5 of the Federal Trade Commission Act by knowingly inducing discriminatory payments and allowances violative of section 2(d) of the amended Clayton Act. Petitioners specify as error (Brief 8, sp. 5) the holding that knowingly inducing a discrimination violative of section 2(d) violates section 5, and so argue (Brief 91-94). We contend (*infra*, pp. 35-39) that the ruling is correct.

The Order to Cease and Desist

Based upon the findings, conclusions, and rulings summarized above, the Commission entered an order to cease and desist (Apdx B, pp. 3b-5b), the first prohibition of which directs petitioners and their agents, representatives and employees, in connection with the offering to purchase

and purchase in commerce of products for resale in outlets operated by petitioners, to cease and desist from:

> Knowingly inducing, or knowingly receiving or accepting, any discrimination in the price of such products by directly or indirectly inducing, receiving or accepting from any seller a net price [petitioners] know or should know is below the net price at which said products of like grade and quality are being sold by such seller to other customers where [petitioners] are competing with the purchaser paying the higher price or with a customer of the purchaser paying the higher price.

The order provides that in determining "net price" under the terms of the order "there shall be taken into account all discounts, rebates, allowances, deductions or other terms and conditions of sale by which net prices are affected."

The second prohibition of the order directs petitioners and their agents, representatives and employees, directly or through any corporate or other device, in or in connection with any purchase in commerce, to cease and desist from:

> Inducing and receiving anything of any value from any supplier as compensation or in consideration for services or facilities furnished by or through [petitioners] in connection with the processing, handling, sale or offering for sale of products purchased from such supplier, when [petitioners] know or should know that such compensation or consideration is not being affirmatively offered or otherwise made available by such supplier on proportionately equal terms to all of its other customers competing with [petitioners] in the sale and distribution of such supplier's products, including other customers who resell to purchasers who compete with [petitioners] in the resale of such supplier's products.

Petitioners specify as error the order's application to the individual petitioners (Brief 8, sp. 6), and argue that issue (Brief 95-96). We contend (*infra*, pp. 91-92)

that, upon the facts of this case, the Commission's decision to include them in the order was not an abuse of its discretion.

Petitioners also specify as purported error an allegation that the Commission failed to frame the order in terms bearing a reasonable relation to the violations found (Brief 8, sp. 7), and in support of that specification argue (Brief 96-101) that certain provisions included in the proposed order drafted by the hearing examiner (which the Commission did not adopt), but not in the order drafted and issued by the Commission, are improper. We contend (*infra*, p. 91) that since petitioners' specification is misdirected and their criticisms of those provisions are moot, their argument presents no issue, but that in any event the Commission's order is clearly proper in scope and terms.

Finally, despite having just criticized those terms which are not in the Commission's actual order, they argue (Brief 102) that a provision in that actual order, but not in the hearing examiner's proposed one, is improper. We contend (*infra*, p. 91) that its inclusion was not erroneous.

SUMMARY OF ARGUMENT

I. Much of petitioners' argument is vitiated by their reliance upon purported facts contrary to findings neither specified as error nor argued as unsupported by substantial evidence, and, as to the findings which they do argue as erroneous, by their mistaken expectation of a trial *de novo* upon the administrative complaint and the evidentiary record, rather than an appellate review as to the substantiality of the evidence, to which they are limited by applicable statutes and controlling decisions.

Petitioners' statement of the case is inadequate and inaccurate, consisting merely of a reference to the administrative complaint and argumentative statements as to a few purported facts. Throughout their brief they ignore

the findings, make assertions of purported fact contrary to them, and cite favorable scraps of evidence as though that settled the matter on this review. Their arguments thus are of the sort properly addressed to an original trier of the facts rather than an appellate court.

Contentions which depend upon purported facts contrary to findings neither specified as error nor argued as unsupported by substantial evidence should be disregarded. Contentions which depend upon *de novo* trial of facts are likewise invalid.

Evidence is substantial if it is enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury. The "substantial evidence" rule places a greater limitation upon reviewing courts than the "clearly erroneous" rule applicable to review of findings of a trial judge sitting without a jury.

In deciding whether evidence is substantial courts will not substitute their judgment for that of the Commission nor pass upon the credibility of witnesses or the weight to be given testimony, or choose between permissible inferences.

II. The Commission correctly determined that petitioners have violated section 5 of the Federal Trade Commission Act by knowingly inducing and receiving discriminatory payments prohibited by section 2(d) of the amended Clayton Act.

A. The knowing inducement and receipt of discriminatory payments of the type declared illegal by section 2(d) of the Clayton Act constitute unfair methods of competition and unfair acts and practices in violation of section 5 of the Federal Trade Commission Act.

The Commission and courts in a number of cases have uniformly held that practice to violate the Federal Trade Commission Act. The decisions simply apply the familiar, long-established principle that it is an unfair trade practice violative of section 5 to procure, participate in, or

aid and abet the use by another of a trade practice which is illegal, unfair, or against public policy.

By inducing and receiving discriminatory payments petitioners contravened established federal antitrust policy, and caused suppliers to violate federal statutes.

The Commission's use of section 5 to enforce established policies, by proceeding under it against business methods contrary to the policy of those statutes, is in strict accordance with Congressional purpose and has received explicit Supreme Court approval.

B. The Commission correctly determined that petitioners' suppliers have violated section 2(d) of the Clayton Act by contracting to make and making their payments to petitioners.

1. Substantial evidence supports the Commission's findings to the effect that during petitioners' 1957 coupon-book sale, Hudson House was another customer of Tri-Valley competing with petitioners in the distribution of canned peaches of like grade and quality.

Petitioners' contention that the evidence does not show that the contents of Tri-Valley's cans of fancy-grade peaches sold to petitioners was of the same grade and quality as those sold to Hudson House is incorrect. The invoices show that the shipments were identical in every identifiable way except label. The mere fact that the goods bear the private brands of the buyers is insufficient to rebut the inference of identity that is raised by the use of identical descriptions by the sellers and identical treatment by both sellers and buyers. The use of identical terms in invoices to describe products necessarily means that the supplier regarded them as substantially identical, and it would be error to treat as important, in determining like grade and quality, factors which the parties concerned considered at the time were too insignificant to warrant different treatment, or even mention. There is no evidence in the record indicating any variation between the contents of the cans involved in the various shipments in this case. Where, as here, identical packages

of a product of a given USDA grade are treated by all concerned as essentially fungible, they are sufficiently alike to be subject to the Clayton Act's requirements as to nondiscriminatory treatment of competing purchasers.

The Commission's inference that some of the peaches Tri-Valley sold to Hudson House under the latter's private label reached retailers for resale in competition with petitioners retail stores despite commingling by Hudson House with similarly labeled peaches purchased from other suppliers, is a permissible one, and petitioners' contention that the law requires tracing of particular cans from supplier to retailer is erroneous.

When, as here, products of like grade and quality are purchased from several sellers and fungibly commingled in the course of distribution, the specific products of the discriminatory seller need be traced, for 2(d) purposes, only as far as the commingled fungible stock.

2. The undisputed findings support the Commission's inference that during petitioners' 1957 promotion and sale of Idaho Canning Company's canned corn, both Hudson House and Wadhams & Co. were other customers of Idaho competing with petitioners in the distribution of canned corn of like grade and quality.

As in the case of Tri-Valley's peaches, the Commission properly found that some of Idaho Canning's corn reached retail customers of Hudson House and Wadhams & Co. competing in the resale thereof with petitioners' retail stores, and in addition, there is no dispute that those retailers were competing in the resale of commingled stock containing that supplier's products.

3. Substantial evidence supports the Commission's findings to the effect that during petitioners' 1957 and 1958 coupon-book sale and promotion of Burlington Industries' hosiery, Lipman, Wolfe & Co. was another customer of Burlington Industries competing with petitioners in the distribution of hosiery of like grade and quality, and that Burlington did not make available to it during those times any allowances or discounts.

There is no dispute that petitioners and their competitor were selling Burlington Industries' hosiery at the same time. The seller's invoices used the same descriptive designations to identify the hosiery sold to both customers, which sufficiently supports the Commission's finding that the products were of like grade and quality. The testimony of the competitor's hosiery buyer shows that it did not receive and was not offered allowances similar to those granted petitioners.

4. Substantial evidence supports the Commission's findings to the effect that during petitioners' 1956 coupon-book sale and promotion of Cannon Mills towels, Roberts Brothers department store was another customer of Cannon Mills competing with petitioners in the distribution of towels of like grade and quality.

Here also the finding of like grade and quality is properly supported by the supplier's use of identical descriptive designations on its invoices. The finding as to competition in the distribution of the products is properly supported by evidence showing substantially contemporaneous purchases.

5. Substantial evidence supports the Commission's finding to the effect that Phillip Morris did not make available to Oregon Piggly Wiggly Company or to United Grocers, Inc., any payments proportionally equal to those petitioners induced and received from Phillip Morris.

The record shows that Phillip Morris had a regular cooperative promotional program available to all customers on proportionally equal terms, and the payments it made to petitioners in this case were additional ones not paid or offered to petitioners' competitors. They also were for flat sums not related to any quantitative factor in the buyer-seller relationship. Those facts are sufficient to support the Commission's findings that the payments were not available to those competitors and were incapable of being made available on proportionally equal terms.

C. The Commission properly ruled that on the facts of this case both Wadhams & Co. and Hudson House, when acting as wholesalers of the products of the discriminating suppliers, were "other customers" of those suppliers "competing in the distribution of such products or commodities," within the meaning and protection of section 2(d) of the amended Clayton Act.

Petitioners contend that where the recipient of a discriminatory payment or allowance is the owner of retail stores, wholesalers selling to competing retailers cannot, as a matter of law, be considered "other customers competing in the distribution" of the products concerned, within the protection of section 2(d). We submit that the Commission correctly held the section to be applicable to actual competitors without limitation by differences in the functional levels at which they operate. The Commission's construction is in accordance with the statutory language, and is necessary to effectuate the Congressional purpose.

That construction is at odds with a recent ruling of this Court, in a case where the matter was not fully briefed or argued. Because of its great importance to enforcement of the Clayton Act, we submit it should be considered anew.

In order to limit the coverage of section 2(d) in the manner petitioners wish, it would have to be construed as if it contained, in place of "competing in the distribution," a phrase such as "competing at the same functional level, as at wholesale or retail, in the direct resale to customers in the same functional class." Such a construction would be contrary to the language of the Act, which nowhere bases any distinction upon, or even mentions, any of the many functional classes of merchants.

The Robinson-Patman amendments to the Clayton Act were motivated by a purpose to protect the small independent retailer and his wholesaler suppliers from the great direct-purchasing power of their larger competitors. Petitioners' construction of section 2(d) would thus deprive of its protection the very merchants it was enacted

to protect, while increasing their disadvantage by requiring that other direct-buying chains with which they compete also be given the allowances. Adoption of the Commission's construction is the only way to avoid that complete reversal of the intended effect of the section. That construction is not strained, but gives the crucial word—"distribution"—its precise meaning. When, as here, petitioners compete with wholesalers for the favors of sellers when making their purchases, and when both petitioners' retail stores and those wholesalers' customers compete with each other for consumers' favor, petitioners and the wholesalers are in competition "in the distribution of" the products for which both seek to obtain the same consumers' dollars.

The ability of the more than 100 independent retailer-customers of the two wholesalers involved in this case to compete on an equal basis with petitioners depends on their obtaining through those wholesalers the benefits of proportional shares of the promotional allowances given by the suppliers.

Congress intended by the interrelationship of sections 2(a), 2(d), and 2(e) to prevent circumvention of the prohibitions of section 2(a) by use of alternatives for price discriminations. It necessarily follows that in any circumstance in which a price discrimination would violate 2(a), a discriminatory allowance would violate 2(d) and a discriminatory service would violate 2(e). It is well settled that price differentials between wholesalers and retailers are price discriminations within the coverage of section 2(a), and petitioners do not contend otherwise in their arguments concerning the holding that the price differentials between them and the same wholesalers violated that section.

For these reasons we submit that the Court should reconsider this question and hold that, upon proper facts, including those of this case, a wholesaler may be a "customer competing" with a retail chain "in the distribution of" a discriminating supplier's products, within the meaning and protection of section 2(d).

D. The Commission's finding to the effect that petitioners were aware of the facts making illegal the discriminatory payments they induced and received from their suppliers is properly supported by the undisputed findings as to underlying facts, and by the findings petitioners challenge here, which are supported by substantial evidence.

The record shows that petitioners, at the time they induced and received the payments from their suppliers, had information sufficient to put upon them the duty of making inquiry to ascertain whether the suppliers were making such payments available on proportionally equal terms to their competitors. It shows that petitioners knew, or in the exercise of reasonable care should have known, that payments of the kind they received had not been made available to their competitors. It was petitioners who originated the special programs and demanded payment for them, so that the payments necessarily were ones other customers were not then receiving, and therefore the payments could not be available to those other customers unless the suppliers took action to make them so. Petitioners, knowing this, had the duty to make inquiry of the buyers as to whether or not they were doing so. There is nothing in statute or decision which precludes the imposition of such a duty of reasonable inquiry upon a buyer. Petitioners' protestations of ignorance cannot avail, because it is settled law that "everyone is presumed to know everything he can learn upon inquiry, when he has facts in his possession which suggest inquiry," and "must be charged with knowledge of that which it was his duty to know."

Furthermore, the record shows that petitioners demanded and contracted for the discriminatory preferences they received, and cannot now be heard to deny they knew they were getting them.

III. The Commission correctly determined that petitioners have violated section 2(f) of the amended Clayton Act by knowingly inducing and receiving price discriminations prohibited by section 2(a) of that Act.

A. Because of a subsequent Commission decision in a related case involving, *inter alia,* the same price discriminations by Cannon Mills involved in this case, we do not rely upon those price discriminations in this review.

B. The Commission correctly determined that petitioners' suppliers have violated section 2(a) of the Clayton Act by discriminating in price between petitioners and their competitors, and that petitioners were aware of the facts making those discriminations illegal.

1. The Commission properly determined that the price cuts and rebates petitioners induced and received from Tri-Valley, Idaho Canning, and Burlington Industries were "discriminations in price within the meaning and coverage of section 2(a)."

Petitioners' argument that those discriminations were payments for services, within the coverage of section 2 (d), and therefore cannot be price discriminations within the coverage of section 2(a), overlooks the fact that the coverages of those sections overlap. If payments are made in the form of price discriminations, they may violate both sections. The record shows that these discriminations were price cuts and rebates, so they are within section 2(a), and the fact that, as petitioners urge, they might also violate 2(d), is immaterial. It is not true, as petitioners assert, that the Commission in the proceedings it brought against the same suppliers held that those price cuts and rebates were not violations of 2(a), but of 2(d).

2. The Commission's finding that the price discriminations petitioners induced and received might adversely affect competition is not rendered invalid by the circumstance that petitioners' coupon-book sales occur only once each year.

The only attack petitioners make against that finding consists of the erroneous accusation that the Commission "ignored entirely" the fact that the four-week promotion

sales occur once per year, and of the unargued assertion that therefore the effect "must have been temporary and minimal, and insufficient to support a finding of violation." The Commission did not ignore the fact, and petitioners' *ipse dixit* is plainly frivolous.

3. Substantial evidence supports the Commission's findings to the effect that the price discriminations petitioners induced and received from Tri-Valley, Idaho Canning, and Burlington Industries did not "make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered," within the meaning of section 2(a) of the Clayton Act, and that petitioners were so aware.

The Supreme Court held in its leading decision that in a case against a buyer under section 2(f) it is the Commission's burden to show that discriminations the buyer induced or received were not cost-justified, and that he was so aware. The Court discussed a few types of evidence which would suffice to support such findings. It said that the buyer which 2(f) was intended to reach was the one who, "knowing full well that there was little likelihood of a defense for the seller, nevertheless proceeded to exert pressure for lower prices." This record establishes both such knowledge in and such pressure by petitioners.

The Court said that a buyer's "trade experience in a particular situation can afford a sufficient degree of knowledge to provide a basis for prosecution." The record shows that petitioners have had long and deep trade experience in the exact situation. The Court also said that if methods or quantities of the competing purchasers differ, it is sufficient to "show that such differences could not give rise to sufficient savings in the cost of manufacture, sale or delivery to justify the price differential, and that the buyer, knowing these were the only differences, should have known that they could not give rise to sufficient cost savings." The record shows that there were no differences in the *methods* by which petitioners made the purchases in question, and that the insignifi-

cant differences in costs resulting from the *quantities* in which they purchased were obviously insufficient to cost-justify 33⅓% price discriminations, and that petitioners were, or in the exercise of reasonable care would have been, so aware. As the Supreme Court said, "a showing that the cost differences are very small compared with the price differential should be sufficient."

The Court also left open the question of whether, in proper cases, "other proof may be sufficient to justify shifting the burden of introducing evidence that the buyer is or is not an unsuspecting recipient of prohibited discriminations." The record shows that petitioners were not mere "recipients" of the discriminations, and that no reasonable person in their circumstances could have been "unsuspecting" of the discriminations' illegality.

Furthermore, even if there had in fact been cost differences equaling the discriminations, they would not constitute cost-justification under section 2(a). This is because that defense is allowed only for price discriminations which result from and are based upon cost savings. Where, as here, the claimed cost savings, if they had existed, would have been the result of the increased sales generated by the discriminations, they cannot be used in a "boot-strap" justification of those discriminations. If the rule were otherwise, any large special-occasion price discrimination, such as those in this case, would be self-justifying for the sellers if the special sales are successful, and for the buyers if they reasonably believe they will be successful.

IV. The Commission's inclusion of the individual petitioners, by name, in its order to cease and desist, and its inclusion in the prohibition against inducing and receiving discriminatory payments of a phrase making explicit its valid application to discriminations between petitioners and wholesalers competing with them, was not an abuse of discretion.

The rest of petitioners' attack upon the Commission's order is misdirected, since it consists merely of criticisms

of specific phrases used by the hearing examiner in his proposed order, which the Commission did not include in the order it drafted and issued.

ARGUMENT

I. Much of petitioners' argument is vitiated by their reliance upon purported facts contrary to findings neither specified as error nor argued as unsupported by substantial evidence, and, as to the findings which they do argue as erroneous, by their mistaken expectation of a trial de novo upon the administrative complaint and the evidentiary record, rather than the appellate review as to the substantiality of the evidence, to which they are limited by applicable statutes and controlling decisions

In our counterstatement of the case (*supra*, pp. 3-20) we have attempted to identify and present the questions involved in this review, and describe the manner in which they are raised by the events of record and petitioners' contentions here. Our doing so has been made necessary by (1) petitioners' failure to specify with particularity any of the findings with which they appear to take issue, (2) their presentation, under the label of "Statement of the Case," of what really is a misleading mixture of a few of the facts found, purported facts contrary to other findings, and a summary of the administrative complaint which initiated the proceeding below, and (3) their failure to describe any of the other findings or rulings—even those with which they take issue in their arguments.[9]

It is evident from these and other features of petitioners' brief that they expect from this Court a trial *de novo* upon the Commission's complaint and the evi-

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[9] *Cf. Thys Company* v. *Anglo California National Bank,* 219 F.2d 131, 132-34 (9th Cir. 1955), *cert. denied,* 349 U.S. 946.

dentiary record, rather than an appellate review of the Commission's decision. They have briefed the case almost as though that decision had no significance here apart from its mere existence, and their arguments are of the sort properly addressed only to an original trier of facts, in support of proposed findings, rather than to an appellate court, in support of an attack upon existing findings.

That fundamental error vitiates much of petitioners' argument in this Court. It is well established that court review of Commission decisions is "appellate and revisory merely, and not an exercise of original jurisdiction by the court itself." *Federal Trade Commission* v. *Eastman Kodak Co.*, 274 U.S. 619, 624 (1927). Contentions in an appellate proceeding which, as many of petitioners' do, depend upon purported facts contrary to findings neither specified as error nor argued as unsupported by substantial evidence, should be disregarded. Contentions which depend upon the reviewing court's disregarding the appellate nature of the proceeding and making new findings from the evidence are likewise invalid, because such trial *de novo* is interdicted by plain statutory proscriptions and consistent court decisions. Section 11(c) of the Clayton Act (73 Stat. 243, 244, as amended, 15 U.S.C. 21(c)), which authorizes and controls the review of the first paragraph of the Commission's order, provides that "the findings of the commission or board as to the facts, if supported by substantial evidence, shall be conclusive." Section 5(c) of the Federal Trade Commission Act (52 Stat. 112, 15 U.S.C. 45(c)), which authorizes and controls review of the second paragraph of the Commission's order, contains a similar provision. They have the same meaning as section 10(e)(B)(5) of the Administrative Procedure Act (60 Stat. 243, 5 U.S.C. 1009(e)), which authorizes reviewing courts to set aside agency findings which are "unsupported by substantial evidence." See 4 Davis, *Administrative Law*, 116-17.

The Supreme Court has held that evidence is substantial within the meaning of those statutes if it is "enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury." *Universal Camera Corp.* v. *National Labor Relations Board*, 340 U.S. 474, 477 (1951). The "substantial evidence" rule places a greater limitation upon reviewing courts than the "clearly erroneous" rule applicable to review of findings of a judge sitting without a jury. *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395 (1948). In addition, the statutory grant of authority to reviewing courts to set aside agency findings unsupported by substantial evidence was not intended "to negative the function of * * * those agencies presumably equipped or informed by experience to deal with a specialized field of knowledge, whose findings within that field carry the authority of an expertness which courts do not possess and therefore must respect." "Nor does it mean that even as to matters not requiring expertise a court may displace the [Commission's] choice between two fairly conflicting views, even though the court would justifiably have made a different choice had the matter been before it *de novo.*" *Universal Camera, supra*, 340 U.S. at 488. *Accord, Carter Products, Inc.* v. *Federal Trade Commission*, 268 F.2d 461, 492 (9th Cir. 1959), *cert. denied*, 361 U.S. 884.

As this Court has held, in deciding whether supporting evidence is substantial, "courts will not substitute their judgment for that of the Commission" nor "pass upon the credibility of the witnesses and the weight to be given their testimony in the light of it all, conflicting or otherwise," and "the findings of the Commission, when * * * the record as a whole gives them substantial support, are final *even though the evidence is so conflicting that it might have supported the contrary* had such findings been made." *DeGorter* v. *Federal Trade Commission*, 244 F.

2d 270, 273 (9th Cir. 1957). Furthermore, as this Court held in *Carter Products, supra*, 268 F.2d at 491, it is not the duty of reviewing courts "to weigh the evidence before the Commission and/or choose between inferences which might arise from an appraisal of the probative worth of this evidence, since exercising those important functions became the primary duty of the Commission"; it is "for the Hearing Examiner and the Commission, not the Courts, to pass upon the credibility of witnesses and the weight to be accorded their testimony" as well as "the *weight* to be given by the Commission to the facts and circumstances admitted as well as inferences reasonably to be drawn therefrom"; and "the possibility of drawing either of two inconsistent inferences from the evidence does not prevent the Commission from drawing one of them."

Those holdings by this Court are in conformity with those of the Supreme Court and other courts of appeals. See, *e.g.*, *Corn Products Refining Co.* v. *Federal Trade Commission*, 324 U.S. 726, 739 (1945); *Federal Trade Commission* v. *Pacific States Paper Trade Ass'n*, 273 U.S. 52, 63 (1927); *National Labor Relations Board* v. *Nevada Consolidated Copper Corp.*, 316 U.S. 105, 106 (1942); *Federal Trade Commission* v. *Standard Education Society*, 302 U.S. 112, 117 (1937); *Federal Trade Commission* v. *Sewell*, 353 U.S. 969 (1957).

We contend that the Commission's findings in this case are conclusive as to the facts, because those which petitioners attack in their arguments are supported by substantial evidence (as we shall show below), and those which they do not argue as lacking such support are not placed in issue merely because petitioners ignore them or base their arguments on contrary assertions.

II. The Commission correctly determined that petitioners have violated section 5 of the Federal Trade Commission Act by knowingly inducing and receiving discriminatory payments prohibited by section 2(d) of the amended Clayton Act

A. *The knowing inducement and receipt of discriminatory payments of the type declared illegal by section 2(d) of the Clayton Act constitute unfair methods of competition and unfair acts and practices in violation of section 5 of the Federal Trade Commission Act*

This review involves a practice which the Commission and the courts in a number of cases have uniformly held to violate the Federal Trade Commission Act. Earlier cases include In re *United Cigar-Whelan Stores Corporation,* 53 F.T.C. 102 (1956); In re *Trifari, Kruseman & Fishel, Inc.,* 55 F.T.C. 397 (1958); In re *Keystone Mfg. Co., Inc.,* 55 F.T.C. 885 (1958); In re *Grand Union Co.,* 57 F.T.C. 382 (1960), *aff'd,* 300 F.2d 92 (2d Cir. 1962); In re *American News Co.,* 58 F.T.C. 10 (1961), *aff'd,* 300 F.2d 104 (2d Cir. 1962), *cert. denied,* 371 U.S. 824; In re *Giant Food Inc.,* 58 F.T.C. 977 (1961), *aff'd,* 307 F.2d 184 (D.C. Cir. 1962), *cert. denied,* 372 U.S. 910 (1963); *R. H. Macy & Co., Inc* v. *Federal Trade Commission,* 326 F.2d 445 (2d Cir. 1964); *Federal Trade Commission* v. *J. Weingarten, Inc.,* 336 F.2d 687, 693 n. 16 (5th Cir. 1964), *cert. denied,* March 2, 1965, 33 LW 3285.

Petitioners' criticism of the rule of law announced in those decisions is entirely misplaced. It is simply an application of the familiar, long-established principle that it is an unfair trade practice violative of section 5 to procure, participate in, or aid and abet the use by another of a trade practice which is illegal, unfair or against public policy. See, *e.g., Federal Trade Commission* v. *Winsted Hosiery Co.,* 258 U.S. 483, 494 (1922). Wide notice of the applicability of that principle to the practice in this case has been given not only by the decisions cited above but also by the Commission's various

Trade Practice Rules promulgated as guides to specific industries.[10]

By inducing and receiving the discriminatory payments from their suppliers petitioners contravened the established federal antitrust policy embodied in section 2(d) of the Clayton Act and section 3 of the Robinson-Patman Act,[11] caused their suppliers to commit violations of both

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[10] See, *e.g.*, the "Trade Practice Rules for the Grocery Industry," promulgated March 19, 1952 (17 Fed. Reg. 2357-59; 16 C.F.R. 209.5, 209.27).

[11] Section 2(d) of the Clayton Act, as amended, 49 Stat. 1527, 15 U.S.C. 13(d) provides—

> That it shall be unlawful for any person engaged in commerce to pay or contract for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale, or offering for sale of any products or commodities manufactured, sold, or offered for sale by such person, unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities.

Section 3 of the Robinson-Patman Act, 49 Stat. 1528, 15 U.S.C. 13a, provides in pertinent part that—

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, to be a party to, or assist in, any transaction of sale, or contract to sell, which discriminates to his knowledge against competitors of the purchaser, in that, any discount, rebate, allowance, or advertising service charge is granted to the purchaser over and above any discount, rebate, allowance, or advertising service charge available at the time of such transaction to said competitors in respect of a sale of goods of like grade, quality and guantity * * *.

Both provisions apply to sellers, and the latter (a criminal statute) applies also to buyers, both by its own terms and by virtue of 18 U.S.C. 2.

those statutes, and contravened the latter Act themselves. By enacting those statutes the Congress made it conclusive that it is contrary to federal antitrust objectives for suppliers to pay and their customers to receive discriminatory payments for reselling services. The Commission and court decisions in this case and those cited above are valid implementations of that legislative determination.

Petitioners' attack upon those rulings (Brief 91-94) misrepresents them and the explanations given by the Commission and the courts in making them. As the Commission and the courts have noted (*e.g.*, *Grand Union*, 57 F.T.C. at 422; 300 F.2d at 96), the Congress' omission to mention the practice when amending section 2 of the Clayton Act was inadvertent rather than studious, and therefore the omission cannot be considered an intended curtailment of the Commission's authority, under its organic Act, to prohibit practices contrary to established public policy. The fact that the Clayton Act explicitly denounces certain practices and omits others does not mean that practices denounced or omitted are outside the coverage of the Federal Trade Commission Act. This is made clear by the fact that the Clayton Act was enacted, not because the actions it denounced or the field of economic activity to which it pertained was outside the coverage of the Federal Trade Commission Act, but because the Congress wished to insure that the actions explicitly dealt with in the Clayton Act would not be considered legal despite section 5. 51 Cong. Rec. 15829 (1914).

The Commission's use of section 5 to enforce established public policies, by proceeding under it against business methods contrary to those policies but not violative of any specific statutory provision, is in strict accordance with Congressional purpose and has received explicit Supreme Court approval. *Fashion Originators Guild* v. *Federal Trade Commission*, 312 U.S. 457, 463 (1941); [12] *Federal*

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[12] The Court said (312 U.S. at 463): "If the purpose and practice * * * runs counter to the public policy declared in the Sherman and Clayton Acts, the Federal Trade Commission has the power to suppress it as an unfair method of compe-

Trade Commission v. *Cement Institute*, 333 U.S. 683, 694 (1948); *Federal Trade Commission* v. *Motion Picture Advertising Service Co.*, 344 U.S. 392, 394-95 (1953); *Grand Union, supra*, 300 F.2d at 98-99.[13]

The use of section 5 in this way was approved in advance by the Congress which enacted it and created the Commission to enforce it, as the legislative history of the Act shows in report and debate. H.R. Rep. No. 1142, 63d Cong., 2d Sess. (1914), pp. 18-19 (relating to H.R. 15,613, as reported by the Conference Committee and enacted as the 1914 Federal Trade Commission Act); 51 Cong. Rec. 14,928-29 (1914). See also *Humphrey's Executor* v. *United States*, 295 U.S. 602, 624, 628 (1935).

The Congressional purpose and the Supreme Court's decisions show that the coverage of section 5 extends to all trade practices which, in the language of the Supreme Court in *Federal Trade Commission* v. *R. F. Keppel & Bro.*, 291 U.S. 304, 313 (1934), are unfair in "the normal meaning of the word." In this case there can be no doubt that it is unfair, in any normal meaning of that word, for petitioners to receive from their vendors the substantial benefit of promotional payments not made available to their competitors in the distribution of the vendors' products. It is unfair to the vendors who jeopar-

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tion." Throughout that opinion the Court repeatedly used language emphasizing that the Commission may prohibit practices contrary to the public policy underlying those Acts, without regard to whether or not they violate their terms. See, *e.g.*, pp. 465-66.

[13] The Court held that the Commission properly may resort to section 5 "to realize the basic policy of the Robinson-Patman Act, which was to prevent the abuse of buying power," and, since "activity which 'runs counter to the public policy declared in the Sherman and Clayton Acts' is an unfair method of competition," the Commission may declare conduct of the type concerned here to be "unfair" and thus violative of section 5, "using the policies of § 2(d) as a yardstick" (300 F.2d at 98-99).

dize their relations with their other customers and violate the Clayton and Robinson-Patman Acts, it is unfair to petitioners' competitors who are placed at a disadvantage in their competition with petitioners, and it is unfair to the public whose interest in the preservation of equality of opportunity among competitors lies at the root of the public policy expressed in the Clayton Act and contravened by petitioners' practices.[14]

B. *The Commission correctly determined that petitioners' suppliers have violated section 2(d) of the Clayton Act by contracting to make and making their payments to petitioners*

A breakdown of the provisions of section 2(d) shows that to support a ruling that a supplier has violated that section it must be properly found that—

[14] Petitioners contend (Brief 93-94) that no practice can be held unfair under the Federal Trade Commission Act without findings of actual or probable adverse effect upon competition. The contention is erroneous. Such findings merely constitute valid alternative grounds for holding practices unfair, not required elements of proof in every section 5 case, as is shown by the decisions petitioners cite. It is also shown by the legislative history of section 5 and its amendments; for example, it was said in debate upon the Wheeler-Lea Act (52 Stat. 111 *et seq.*), which amended the section to prevent misunderstanding upon this precise point, that "when the Federal Trade Commission Act was originally passed it was hoped by the Congress, as committee reports will show, that it would give the Commission power to stop certain unfair and deceptive practices if they were against public interest and were detrimental, regardless of whether or not they resulted in financial injury to some competitor." 80 Cong. Rec. 6436 (1936).

In cases such as this, where the unfairness is clearly established by factors other than competitive injury, findings on that point are not necessary. Section 2(d) requires no such finding, so it in any event would not be required in a proceeding to enforce its policy, under section 5. *Grand Union supra,* 300 F.2d at 99; *Giant Food, supra,* 307 F.2d at 186; *Macy, supra,* 326 U.S. at 450.

(1) the supplier is engaged in commerce, and in the course thereof

(2) contracted to make or made payments of something of value

(3) to or for the benefit of a customer

(4) as compensation or in consideration for services or facilities furnished by or through the customer

(5) in connection with the processing, handling, sale, or offering for sale of the supplier's products or commodities

(6) without such payment or consideration being available

(7) on proportionally equal terms

(8) to all other customers competing in the distribution

(9) of such products or commodities.

The Commission made findings as to all of those factors. Petitioners do not challenge here the findings as to the first five factors listed above. They contend, however, that the evidence does not sufficiently prove one or more of the last four with respect to each of their suppliers. The contention is erroneous.

1. Substantial evidence supports the Commission's findings to the effect that during petitioners' 1957 coupon-book sale and promotion of Tri-Valley canned peaches, Hudson House was another customer of Tri-Valley competing with petitioners in the distribution of canned peaches of like grade and quality

The Commission found and petitioners concede (Brief 56) that during September and October 1957 they received from Tri-Valley 2,200 cases of its canned peaches, packed under Fred Meyer's private label, for resale during the coupon-book sale, and that during the same two

months Hudson House purchased, under its own private label, 175 cases of identically described merchandise. They argue, however, that the evidence does not show that the contents of the cans were of like grade and quality, and in support of that argument misstate the nature of the part of the evidence upon which they rely. Contrary to their argument, the witnesses did not say that there were differences in grade within the grade designations showing on the invoices. The invoices (CX 42A-43B, 44-47) show that the shipments of peaches sold to Hudson House were identical in every identifiable way (except label) with those sold to petitioners. For example, CX 44 is an invoice from Tri-Valley to Fred Meyer, Inc., dated October 19, 1957, showing shipment on October 8, 1957. The first invoice line shows a sale of 200 24-can cases of size 2½ cans of "CHO HVY YC PCHS HVS" from plant "MO." Correspondingly, CX 42A is an invoice from Tri-Valley to Hudson House dated October 11, 1957, showing shipment on October 9, 1957. The second invoice line shows a sale of 100 24-can cases of 2½ cans of "CHO HVY HVS YC PEACHES" from plant "MO." The only differences on these two invoice lines are the designations of the private labels and the quantities in the shipments. As succinctly stated by the Commission (R. 96):

> A supplier's use of identical descriptive data on invoices to favored and non-favored customers constitutes probative evidence and establishes, prima facie, the fact of like grade and quality. [Petitioners] had every opportunity to show, if they could, that this evidence was inaccurate. The mere fact that the goods bear the private brands of the respective buyers is clearly insufficient to rebut the inference of identity that is raised by the similarity of supplier descriptions.[15]

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[15] It cannot be doubted that the invoices constitute *prima facie* evidence of the facts stated therein or shown thereby. See, *e.g.*, *Straus* v. *Victor Talking Machine Co.*, 297 Fed. 791,

The supplier's use of identical terms in the invoices to describe the products necessarily means that it regarded the products as substantially identical; it would be improper to presume otherwise. Petitioners' contentions suffer from the error that they would require the Commission and the courts to treat as of crucial importance factors which were considered at the time to be too insignificant to warrant different treatment or even mention in the invoices. *Cf. United States* v. *Bryan*, 339 U.S. 323, 332 (1950). The invoices are no less substantial evidence of likeness of grade and quality than those reviewed by this Court in *Tri-Valley Packing Association* v. *Federal Trade Commission*, 329 F.2d 694 (9th Cir. 1964).

Against this evidence that the buyers and sellers of those peaches regarded them as identical for all commercial purposes in the marketplace, petitioners argue only that the contents of cans may vary within their USDA commercial grades because of variations in geographical area where grown, conditions of packing, etc. They produced no evidence of any such variation between the shipments involved in this case, however, and rely only upon the supposition that such variations might have existed. That reliance is misplaced, for two reasons. First, the mere supposition is not enough, in the face of the evidence that buyer and seller treated the cans as

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804-5 (2d Cir. 1924; *Central Paper Co.* v. *Southwick,* 56 F.2d 593, 597-98 (6th Cir. 1932).

The Commission's position is consistent with the decisions in *Atalanta Trading Corp.* v. *Federal Trade Commission,* 258 F.2d 365 (2d Cir. 1958), and In re *Henry Rosenfeld, Inc.,* 52 F.T.C. 1535 (1956), first noted by petitioners at p. 39 of their brief, as well as in In re *Universal-Rundle Corp.,* 3 CCH Trade Reg. Rep. ¶ 16,948 (1964), first cited by petitioners at p. 40 of their brief. Petitioners, we submit, have failed to show otherwise.

commercially identical, to compel the conclusion that there were such differences and thereby make the Commission's inference of likeness of grade and quality an impermissible one. Second, even if the supposition were correct, it would not refute the finding, because variations from can to can which are too minor to be of commercial significance in the marketplace, are plainly not enough to make the products unlike in "grade and quality" for purposes of the Clayton Act. Where, as here, identical (except for label) packages of a product of a given USDA grade are treated by all concerned as essentially fungible, then plainly they are sufficiently alike to be subject to the Clayton Act's requirements as to nondiscriminatory treatment of competing purchasers.[16]

In addition to arguing (Brief 26-37) that Hudson House is a wholesaler and therefore as a matter of law cannot be considered a customer of Tri-Valley competing with petitioners in the distribution of Tri-Valley products (an error which we discuss below, pp. 57-66), petitioners also argue (Brief 58-60) that the evidence does not sufficiently show that the peaches sold to Hudson House were distributed to retailers in the Portland area competing with petitioners' retail stores. That contention also is without merit.

The Commission found (R. 93-95), and petitioners do not dispute here, that the peaches Tri-Valley sold to Hudson House under the latter's private label were commingled by Hudson House with peaches purchased from other suppliers, that cans bearing the Hudson House label appeared on the shelves of retailers for resale in competition with petitioners, that because of the commingling it had not been possible to trace particular cans

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[16] *Cf. Bruces Juices, Inc.* v. *American Can Co.*, 87 F. Supp. 985, 987 (S.D. Fla. 1949), *aff'd,* 187 F.2d 919, 924 (5th Cir. 1951); *Moog Industries, Inc.* v. *Federal Trade Commission,* 238 F.2d 43, 49-50 (8th Cir. 1956), *aff'd,* 355 U.S. 411 (1958).

from Tri-Valley to particular retail stores, but that the possibility that all Tri-Valley products by chance found their way to other areas was too remote for consideration.

Petitioners erroneously argue (Brief 58-60) that the fact that Hudson House's customers actually stocked and resold Tri-Valley products during the relevant time period cannot be inferred, but must be proved by direct evidence consisting of a tracing of particular cans. This subject is plainly proper for decision by logical inference from competent evidence, as this Court indicated in *Tri-Valley Packing Association* v. *Federal Trade Commission*, 329 F.2d 694, 708-9 (1964), and the Commission's inference from the evidence plainly is a logically permissible one. The evidence shows, as petitioners recognize (Brief 59-60) that retailer outlets in the Portland area, who compete with petitioners' retail stores, had purchased "Hudson House" peaches from Tri-Valley. The Vice President and Manager of the wholesale division of Hudson House testified (R. 245-47) that it purchased canned fruits and vegetables from Tri-Valley and distributed them to various retailers in the Portland area, that CX 67A through 67Z5 is a list of its larger customer retail stores, upon which those not checked are in the Portland area, and that the stores on the list buy approximately 85% of its volume. We count 287 stores on that list, of which 127 (45%) are in the Portland area, and therefore are in retail competition with petitioners' retail stores.

The former manager of one of those stores testified (R. 510) that his store had sold Hudson House peaches during 1957, that all his purchases of peaches (and of corn) had been from Hudson House "for the last 10 or 11 years" (R. 518), that his store did not keep records showing purchases and inventories of peaches and corn (R. 516-17), and that he remembered that in 1957 or 1958 his peach sales dropped off and he "went to Hudson House, knowing about the coupon book," and Hudson House was unable to help him (R. 517).

A partner-proprietor of another retail grocery testified (R. 538-39) that during August, September, and October of 1957 he purchased canned peaches (and canned corn) from Hudson House, and that one of petitioners' stores is located close to his and is his main competitor (R. 539-40).

The proprietor of another retail grocery testified (R. 636) that it is located seven blocks from one of petitioners', with which it competes, that during petitioners' 1957 coupon-book sale he was buying and reselling canned peaches (and canned corn) purchased from Hudson House under its private ("My-Te-Fine") label (R. 638), and that the peaches and corn which he purchased from Hudson House and sold under that label were of like grade and quality to those which petitioners advertised in their 1957 coupon book, and sold in competition with him during that sale.

A partner-proprietor of another retail grocery testified (R. 660-61) that Hudson House is its source of supply for canned peaches (and canned corn and tobacco products,) that he competes with petitioners' stores, that canned peaches and corn are important items, and that during petitioners' 1957 coupon-book sale his business fell off and he saw petitioners' peaches and corn in homes of his customers when making deliveries during that period.

This evidence is more than sufficient to make permissible the Commission's inference that some of the Tri-Valley-packed Hudson House canned peaches were present on the shelves of retail groceries competing with petitioners' retail stores in the resale of peaches during the 1957 coupon-book sale, and to support the Commission's determination that, in distributing those peaches to retail stores competing with petitioners' in their resale to consumers, Hudson House was *in fact* competing in the distribution of those cans of peaches and corn at the time of petitioners' coupon-book sales.[17]

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[17] Petitioners also appear to argue (Brief 41) that inequality of payments are not proscribed by section 2(d) un-

But in addition, as this Court held in *Tri-Valley, supra,* 329 F.2d at 698, with respect to the affected line of commerce under the 2(a) count in that case, the competition intended to be protected by section 2 is not limited to that in the seller's goods alone. Section 2(d) does not proscribe inequality of treatment of those competing in the distribution of the *seller's products only*, but of those "competing in the distribution of *such* products or commodities." The result is that when, as here, products of like grade and quality are purchased from several sellers and fungibly commingled in the course of distribution, the specific products of the discriminating seller need be

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less the discriminating seller's sales were made at about the same time. The evidence cited above shows that Tri-Valley's sales to petitioners and to Hudson House were simultaneous, but we nevertheless must point out that the argument is erroneous. The statute is in terms of simultaneity of competition in the distribution of the products, not of their purchase. This was plainly intentional, for equality is needed at the time of competition in distribution, and to permit inequality of treatment because of different dates of purchase would have made evasion easy. Time of purchases by different customers is therefore not the element of proof, but merely possible relevant evidence as to simultaneity of competition in distribution, as in *Atalanta Trading Corp.* v. *Federal Trade Commission,* 258 F.2d 365, 372 (2d Cir. 1958), where sales (and deliveries) of perishable products to favored and nonfavored customers were separated by several months. See also *Hartley & Parker, Inc.* v. *Florida Beverage Corp.,* 307 F.2d 916, 921 (5th Cir. 1962).

Where, as here, the arrangement between seller and favored buyer is for payments to be made for promotional services to be rendered at a specified future time, then the seller's obligation is to make similar payments available on proportionally equal terms to its other customers competing with the recipient of the payments at the time of the promotion, regardless of the time-separation between the date upon which the arrangement is made and the date the services are to be performed.

traced, for 2(d) purposes, only as far as the commingled fungible stock, and that stock should be regarded as composed in its entirety of "such" products or commodities. Only in this way can the marketplace realities of cases such as this be taken into account without frustrating the Act's purpose to afford small competitors equality of purchasing opportunity with larger ones.

There is nothing novel in this proposition of law concerning intermingled products of like grade and quality which are treated in the market place as composing a quasi-fungible mass; it has been the rationale underlying many decisions under many statutes. See, *e.g.*, *Currin* v. *Wallace*, 306 U.S. 1, 11 (1939); *United States* v. *Rock Royal Cooperative, Inc.*, 307 U.S. 553, 551-69 (1939); *Moog Industries, Inc.* v. *Federal Trade Commission*, 238 F.2d 43, 49-50 (8th Cir. 1956), *aff'd*, 355 U.S. 411 (1958); In re *Fruitvale Canning Co.*, 52 F.T.C. 1504, 1506-7, 1512 (1956), *pet. to rev. dismissed on stipulation*, Ninth Circuit No. 15,246, January 30, 1957.

2. The undisputed findings support the Commission's inference to the effect that during petitioners' 1957 promotion and sale of Idaho Canning Company's canned corn, both Hudson House and Wadhams & Co. were other customers of Idaho Canning competing with petitioners in the distribution of canned corn of like grade and quality

As in the case of the Tri-Valley transactions, the Commission made findings covering all of the elements or factors of violations of section 2(d) by Idaho Canning Company, with respect to its payments to petitioners and its failure to make such payments available to Hudson House and Wadhams & Co. Petitioners do not take direct issue with any of those findings, saying only (Brief 61) that it has not "been established that any retail customer of the wholesalers [by which they evidently intend Hudson House and Wadhams & Co.] actually stocked, handled or resold the relevant products of Idaho Canning," and er-

roneously state that "the Commission admits that the proof in this respect is deficient."

Petitioners' statement that the Commission has admitted such a deficiency is plainly untrue. They apparently are referring to their argument that particular cans of commingled stock must be traced all the way from the seller to the retailers, in order to find that the wholesaler customer was distributing the seller's products to those retailers. The Commission rejected that argument and found (R. 94-95) that, as in the case of Tri-Valley peaches, some of Idaho Canning's corn could not have failed to reach retailer customers of Hudson House and Wadhams & Co. competing with petitioners' retail stores. We do not think that petitioners' bare assertion of their erroneous belief that section 2(d) requires stock-tracing from producer to retailer raises any issue as to the substantiality of the evidence to support the Commission's findings (R. 82-83) that during the period of petitioners' 1957 coupon-book sale Idaho Canning sold to Hudson House and Wadhams & Co. canned corn, under private labels, alike in grade and quality to that sold petitioners and featured and sold by them in that sale, and (R. 93-95) that those customers commingled that Idaho Canning corn with cans bought from other suppliers under the same labels, and distributed cans from that commingled stock to their retailer-customers competing with petitioners at the time of that sale. Those findings are not even inferentially or impliedly challenged by petitioners; their sole criticism is of the Commission's inference (R. 94-95), based on those findings, that some cans of Idaho Canning's corn inevitably reached those retail stores. As we have shown above (pp. 42-45), the undisputed facts amply support that inference, but in any event there is no dispute that those retailers were competing in the distribution of products drawn from the commingled fungible stock, and that is sufficient for section 2(d) purposes.

3. Substantial evidence supports the Commission's findings to the effect that during petitioners' 1957 and 1958 coupon-book sale and promotion of Burlington Industries' hosiery, Lipman, Wolfe & Co. was another customer of Burlington Industries competing with petitioners in the distribution of hosiery of like grade and quality, and that Burlington did not make available to it during those times any allowances or discounts

We find in petitioners' brief arguments that the evidence fails to establish that the hosiery Burlington Industries sold to them and to Lipman, Wolfe & Co., the Portland retail department store, was of like grade and quality (Brief 46-48), or that Lipman, Wolfe's purchases during the sales were contemporaneous with petitioners' advance purchases in anticipation of the sale (Brief 48-50), or that proportionally equal discounts or allowances were not available to Lipman, Wolfe (Brief 50-52). All three contentions are fallacious.

First, as to simultaneity. Petitioners acknowledge that their purchases from Burlington, although contracted for in orders dated in May of 1957 and June of 1958, were for delivery in August-October of those years, and that Lipman, Wolfe purchased Burlington hosiery during the periods July-October 1957 and August-October 1958 (Brief 46-47). Their argument is solely that simultaneity of sales arrangements and contracts is required by section 2(d). This, as we have shown above (p. 45, n. 17) is erroneous; the simultaneity contemplated by the statute is that of distribution rather than purchase, and that simultaneity petitioners do not deny.

Second, as to likeness of grade and quality. Here also petitioners' own account of the evidence, although incomplete, is sufficient to show that the finding is properly supported. They acknowledge (Brief 47) that Burlington's invoices show that during their 1957 sale Lipman, Wolfe purchased 123 dozen pairs of hosiery bearing the same style numbers as hosiery bought by petitioners and

promoted and sold during that sale, and that during the 1958 sale it bought 191 dozen bearing the same style numbers as petitioners' purchases. As we have shown above, a seller's use of a particular style number or name to designate a product is sufficient to permit the inference that all items so designated are identical within manufacturing and commercial tolerances. As against this inference, which the Commission drew in making its finding, petitioners raise only the objections that the products shipped to them and to Lipman, Wolfe bore different labels, and that in ordering the hosiery shipped to them for their sales, they had included certain specifications showing what they wanted to buy (Brief 48). Although there are inaccuracies in petitioners' account of that evidence concerning their orders, they are immaterial because that evidence is itself immaterial here. Because a seller such as Burlington places customers' own private labels on merchandise of any grade or quality they may purchase, differences in such labels are no indication of differences in the contents of the package. Likewise, the fact that a customer's purchase order may specify what it wishes to purchase does not indicate that the item which the seller selects from his product lines to fill that order is in any way different, in grade or quality or otherwise, from other items bearing his identical identification designations, which he sells to other customers at or about the same time. Where, as here, the invoices show that the seller identified with identical designations the items shipped to both the favored and unfavored customers, differences in private labels or in purchase order descriptions do not compel the inference that there were differences in the grade or quality of the merchandise.

Third, as to the finding that Burlington did not make any such allowances or payments available to Lipman, Wolfe. Here also even the evidence whose existence petitioners acknowledge, but the content of which they misunderstand, is plainly substantial. The witness Meier, whose testimony they cite but slight, testified that during the relevant period he had been the Lipman, Wolfe hosiery

buyer (R. 438), that he was the person who would have transacted cooperative advertising arrangements with Burlington (R. 439), that his store advertised their private brand of Burlington hosiery "between two and six times a year" (R. 444), that he had searched his records for indication of payments of promotional or advertising allowances between August and December 1957 (R. 444), that to the best of his knowledge his company was not paid any cooperative funds by Burlington during September and October of 1957 (R. 444-45), that he had searched his records for indication of cooperative advertising allowances or promotional allowances between August and December of 1958 and to the best of his knowledge his company was not paid any during that period (R. 445), that to the best of his recollection he was not offered, during either period, the payment of any cooperative advertising funds from Burlington (R. 445), and that from his experience it would be unusual for Burlington to offer advertising allowances on private label or unbranded hosiery, because of its lower price (R. 445-46). He also testified that he received no discount from Burlington (R. 458), that he would accept any discount available, in many cases sought discounts, and in all cases negotiated with suppliers to get the best terms possible (R. 461).

That evidence is uncontradicted by anything in the record, and it plainly is substantial support for the finding that Burlington did not make available to Lipman, Wolfe any discount or allowance in connection with the latter's resale of Burlington hosiery at the same time Burlington was participating in petitioners' 1957 and 1958 coupon-book promotions and sales.[18]

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[18] Petitioners' further argument (Brief 51-52) concerning possible different ways in which sellers may proportionalize their allowances to different customers, while replete with errors, has nothing to do with the Burlington transactions, because before any issue of proportional equality of allowances or offers can be reached there must have been such allowances or offers to both customers, and here there were none to Lipman, Wolfe.

Since petitioners do not challenge any other aspect of the Commission's conclusion that Burlington Industries' participation in the 1957 and 1958 coupon-book sales constituted violations of section 2(d) of the Clayton Act, we submit that that conclusion should be upheld.

4. Substantial evidence supports the Commission's findings to the effect that during petitioners' 1956 coupon-book sale and promotion of Cannon Mills towels, Roberts Brothers department store was another customer of Cannon Mills competing with petitioners in the distribution of towels of like grade and quality

Petitioners attack the Commission's conclusion that Cannon Mills violated section 2(d) by its participation in the 1956 coupon-book sale, by contending (Brief 53-55) that the evidence does not sufficiently establish that the Cannon Mills towels they promoted and sold were of like grade and quality to those purchased from Cannon Mills by Roberts Brothers, the competing Portland department store, or that that store had such towels on hand during the period of that sale.

As to like grade and quality, their argument is the same here as before, and the answer is the same. They acknowledge (Brief 53) that Cannon Mills' invoices to them and to Roberts Brothers used identical style numbers to designate and identify the towels each purchased. As against this wholly adequate basis for the inference of identity of the products so designated, they argue only that certain other evidence does not corroborate it (Brief 54). The fallacy, of course, is that it needs no corroboration. Since there is nothing in the record which, in the face of the invoice evidence, would compel a contrary inference on this point, that evidence is substantial and the finding conclusive.

Petitioners' argument on the simultaneity requirements of section 2(d) with respect to the Cannon Mills transactions is the reverse of those they made when arguing

about the Tri-Valley, Idaho Canning, and Burlington Industries allowances. There they argued that simultaneity of purchases by the favored and unfavored customers is the criterion; here, where they must admit such simultaneity, they recognize that simultaneity of the customers' resale efforts is the criterion, and that the dates of purchase are evidence pertinent thereto (R. 54-55). In this, of course, they are at last correct although inconsistent, but they are, as usual, in error in their contention that the evidence does not support the Commission's finding on this point.

They acknowledge (Brief 54-55) that they made purchases in March and October of 1956, and that Roberts Brothers made purchases in April, June, and November of that year. They fail to recognize that, just as their purchases were made for later sale, so, inevitably, were Roberts Brothers'. Indeed, since Roberts Brothers, as a department store, was continuously stocking and selling towels, its purchases in April, June, and November clearly were for maintenance of its stock level. Nothing in this record would compel the unlikely inference that its stock of the towels purchased in June was completely gone in August and September, during petitioners' coupon-book promotion and sale, and that it nevertheless neglected to reorder until November.

Since petitioners do not challenge any other of the bases of the Commission's conclusion that Cannon Mills violated section 2(d) of the Clayton Act by participating in petitioners' 1956 coupon-book promotion and sale, we submit that that conclusion should be upheld.

5. Substantial evidence supports the Commission's finding to the effect that Phillip Morris did not make available to Oregon Piggly Wiggly Company or to United Grocers, Inc., any payments proportionally equal to those petitioners induced and received from Phillip Morris

As we summarized above in our counterstatement of the case (pp. 9-10), the Commission found that petitioners

induced and received from Philip Morris in 1956 and 1957 four lump-sum payments for promoting Phillip Morris products, that Phillip Morris then had a regular cooperative advertising program under which it made payments or allowances to all its customers on proportionally equal terms, that the payments petitioners induced and received were not a part of that program but additional thereto, that they were lump-sum payments not based upon or related to any quantitative factor in the buyer-seller relationship between Phillip Morris and petitioners, and that Phillip Morris did not offer any similar payments to Oregon Piggly Wiggly Company or to United Grocers, Inc.

Although petitioners do not specify any of these findings as error, they argue that the evidence does not show that Phillip Morris did not make the same kind of special payments available to those competitors (Brief 89-90), and (Brief 62-66) that the payments they received were not inherently incapable of being offered to other customers on proportionally equal terms. Each of those contentions is erroneous.

The actual evidence in support of the Commission's finding that Phillip Morris did not make similar payments available to those two competitors is clearly substantial. The Commission found (R. 79), and petitioners do not deny, that allowances granted under Phillip Morris regular promotional program were directly and quantitatively related to the volume of the recipients' purchases. It was found, and petitioners do not deny, that both petitioners and Phillip Morris' other customers received those "regular" promotional allowances, and that petitioners received the allowances involved in this case in addition to the regular allowances (R. 76-77). It was found (R. 75-76), and petitioners do not deny here, that the additional payments petitioners received were (1) $500 for Phillip Morris' participation in petitioners' 1956 "Gift Days" promotion, (2) $150 per month during most of 1956 as consideration for petitioners' promotion of Phillip Morris tobacco products, (3) $800 paid on Oc-

tober 24, 1956, as consideration for their promotion of Parliament cigarettes during September 1956, and (4) $400 paid them (in April 1957) in connection with their promotion of Phillip Morris products during their "Thrift Days" promotion.

The witness Skubic testified that she was petitioners' tobacco-buying supervisor (R. 401), and that allowances based upon the volume of purchases were of the kind offered by the manufacturer (R. 415). She testified that she solicited the $500 cash payment, which was given for promotion of Marlboro and Phillip Morris cigarettes (R. 408-9). She solicited the $150 per month payments (R. 409-10), and she agreed that the substance of that transaction was that they displayed cigarettes in preferred locations and received a certain sum for doing so (R. 411). She could not remember what the $800 was received for (R. 412-13.) She testified (R. 413-14) that the reason she knew that a different allowance, for $3 per case on purchases between specified dates, had been initiated by the manufacturer was "because of the type of —this isn't uncommon." She testified (R. 420) that the payment shown on CX 91A (which is the $400 one in April 1957) was a "Thrift Days promotion" with a newspaper advertising tie-in (one week for L & M cigarettes and one for Chesterfields) and that she went to Phillip Morris and asked it to participate.

The witness Henry Meyer testified that he was General Manager of Oregon Piggly Wiggly (R. 292-93), that its stores competed with petitioners' (R. 295), that although he is a brother of petitioner Fred Meyer he owns no interest in the corporate petitioner (R. 301), that his records showed purchases from Phillip Morris in September 1956 and April 1957 (R. 307), that a search of his records showed no payment received from Phillip Morris in 1956 (R. 307-9), and that the only payment received in 1957 was pursuant to an agreement made on March 25, 1957, whereby the Piggly Wiggly stores gave away a carton of Pepsi-Cola with each carton of Phillip Morris

cigarettes and were thereafter reimbursed by Phillip Morris at their cost for the Pepsi-Cola given away (R. 309-10). Testimony given by personnel of United Grocers was to similar effect (see, *e.g.*, R. 602-10, 613-16, 618-19, 621-24).

The witness Eberling testified that he was Phillip Morris' Division Manager supervising the Portland trade area (R. 531-32), that both the corporate petitioner and Piggly Wiggly were direct retailer accounts (R. 532-33). He testified that allowances in which amounts granted are based upon quantities purchased are a "type of arrangement that's made out of the New York office and to all accounts in the United States" (R. 533-35). Regarding the $800 payment in October 1956 to petitioners, he testified that it is not the same type as the prorated allowances (R. 535), and when asked if he could recall making an "offer of the same nature * * * available to competing customers, to all competing customers, on a proportionally equal basis," answered "I can't recall." When asked "do they have to come to you and ask for it," answered, "On a special deal, yes" (R. 535-36). He testified that the $400 payment in April 1957 was of the same type, and when asked "if a competing customer of Fred Meyer wanted that type of an allowance, he would have to come to you and ask for it," he first tried to evade the question by saying "It's available to them," but when counsel insisted "But do you make the offer," answered "No" (R. 536). When further pressed with the question "To your best knowledge and recollection, do you recall making such an offer available to competing customers of Fred Meyer on a proportionally equal basis?" said, "I have no knowledge" (R. 537).

That testimony clearly is substantial evidentiary support for the Commission's findings that those payments were special ones granted in addition to those available to all customers under Phillip Morris' regular program (R. 76-77), that those special deals were not made available to petitioners' competitors (R. 77-79; *cf.* In re *Kay Windsor Frocks, Inc.*, 51 F.T.C. 89, 95 (1954); In re *Chestnut*

Farms Chevy Chase Dairy, 53 F.T.C. 1050, 1060 (1957); *Vanity Fair Paper Mills, Inc.* v. *Federal Trade Commission*, 311 F.2d 480, 484-85 (2d Cir. 1962)), and that even if similar deals had been offered, the offers could not have been upon terms proportionally equal to those petitioners received (R. 79-82; *cf. Vanity Fair*, *supra*, 311 F.2d at 486-87).[19]

Since we find in petitioners' brief no other attacks upon the Commission's determination that Phillip Morris violated section 2(d), we submit that determination should be upheld.

C. ***The Commission properly ruled that on the facts of this case both Wadhams & Co. and Hudson House, when acting as wholesalers of the products of the discriminating suppliers, were "other customers" of those suppliers "competing in the distribution of such products or commodities," within the meaning and protection of section 2(d) of the amended Clayton Act***

Petitioners contend (Brief 29) that where the recipient of a discriminatory payment or allowance is the owner of retail stores, wholesalers selling to competing retailers cannot, as a matter of law, be considered "other customers competing in the distribution" of the products concerned, within the protection of section 2(d). We submit

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[19] If petitioners' bare assertion that United Grocers is a wholesaler (Brief 62) raises any issue here (which we doubt, in view of their failure to specify as error the Commission's contrary determination or the findings on which it was based, or to argue that the determination is error or that the evidence does not support those findings), we submit that the Commission's determination that it is a retailer, on the facts of this case, is properly supported by its undisputed findings and the undisputed principles of law which it applied thereto (R. 85, n. 34).

In any event, as we show in the next section of this brief, section 2(d) would protect United Grocers and its members even if it were to be classified as a wholesaler.

that petitioners are in error, and that the Commission, in reasoning particularly commended to the Court's attention (R. 85-93), has properly interpreted the section to be applicable to actual competitors without limitation by differences in functional levels at which they operate. The Commission's construction is in accordance with the language of the statute, is necessary to effectuate the Congressional purpose in enacting it, and is supported by the decision in *Krug* v. *International Telephone & Telegraph Corp.*, 142 F. Supp. 230, 236 (D.N.J. 1956), and the rationale of former Commissioner Kern, dissenting in part, in In re *Liggett & Myers Tobacco Company, Inc.*, 56 F.T.C. 221, 253-57 (1959).[20]

While the Commission's construction of section 2(d) is at odds with this Court's ruling in *Tri-Valley Packing Association* v. *Federal Trade Commission*, 329 F.2d 694, 707-9 (9th Cir. 1964), we submit that ruling should be reconsidered.[21] The briefs and arguments submitted to the

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[20] See also *State Wholesale Grocers* v. *Great A & P Tea Co.*, 258 F.2d 831, 837-39 (7th Cir. 1958), *cert. denied sub nom., General Foods Corp.* v. *State Wholesale Grocers*, 358 U.S. 947 (1959). Compare *Elizabeth Arden, Inc.* v. *Federal Trade Commission*, 156 F.2d 132, 135 (2d Cir. 1946), *cert. denied*, 331 U.S. 806 (1947).

[21] That ruling, of course, is now the law of the *Tri-Valley* case, in which, pursuant to the Court's remand to the Commission, further administrative proceedings are now being conducted. As this Court has directed in that case (329 F.2d at 710), "[a]ny judicial review following the entry of Commission orders resulting from proceedings on remand may be upon the present record and briefs as appropriately supplemented." We see nothing in the *Tri-Valley* decision that would prevent this Court, upon possible judicial review following the conclusion of the remand proceeding, from exercising its discretion to reconsider its prior ruling respecting the Commission's construction of section 2(d). Whether or not this will be necessary or desirable in the event of further judicial review may be contingent, in part, upon whatever disposition of the present administrative proceeding in *Tri-Valley* is made by the Commission.

Court in *Tri-Valley* indicate that the issue was not fully discussed or squarely presented. It is of great importance to enforcement of the Clayton Act, and has not heretofore been directly considered or ruled upon by any other court of appeals or by the Supreme Court.[22] For these reasons we respectfully request the Court to consider the matter anew.

In order to restrict the coverage of section 2(d) in the manner petitioners wish, it would have to be construed as if it contained, in place of "competing in the distribution," a narrowly restricted phrase such as "competing at the same functional level, as at wholesale or retail, in the direct resale to customers in the same functional class." With due deference, we must submit that such a construction would amount to amendment rather than interpretation and application. The construction, we submit, would be contrary to the plain language of the amended Clayton Act, which nowhere bases any distinction upon, or even mentions, any of the many functional classes into which some writers classify merchants for other purposes. It is highly significant that the statute, as the Commission noted (R. 89), speaks of competition in the "distribution" of products, not merely in their "resale."

The inequitable result that necessarily would follow from petitioners' narrow construction, as the Commission has more fully noted (R. 87-88), was neither intended nor effected when Congress in 1936 enacted the Robinson-Patman amendments to the Clayton Act. As originally enacted in 1914, the Clayton Act was focused on certain predatory practices of large sellers, but after its

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[22] Petitioners' "see also" reference (Brief 31) to decision in *Alhambra Motor Parts* v. *Federal Trade Commission,* 309 F.2d 213 (9th Cir. 1962), incorrectly implies that something in that decision is apposite on this point. That case involved section 2(f) which, as noted, prohibits buyers from inducing and receiving price discriminations prohibited by section 2(a).

passage there grew up large retail chains which exercised great power as buyers. As stated in *Federal Trade Commission* v. *Simplicity Pattern Company*, 360 U.S. 55, 69 (1959):

> A lengthy investigation conducted in the 1930's by the Federal Trade Commission disclosed that several large chain buyers were effectively avoiding § 2 by taking advantage of gaps in its coverage. * * * "Advertising allowances" were paid by the sellers to the large buyers in return for certain promotional services undertaken by the latter. Some sellers furnished special services or facilities to the chain buyers. Lacking the purchasing power to demand comparable advantages, the small independent stores were at a hopeless competitive disadvantage.
>
> The Robinson-Patman amendments were enacted to eliminate these inequities. * * *

And see *Federal Trade Commission* v. *Henry Broch & Co.*, 363 U.S. 166, 174 (1960); *Federal Trade Commission* v. *Anheuser-Busch, Inc.*, 363 U.S. 536, 543-44 (1960); *Grand Union Co.* v. *Federal Trade Commission*, 300 F.2d 92, 96 (2d Cir. 1962).

The Commission was plainly correct in finding that if the narrow construction were adopted "the entire structure of 'independent' food merchants—including the traditional wholesaler and his numerous, small retailer-customers—[would be] placed completely outside the pale of Section 2(d) of the amended Clayton Act insofar as their competition with the direct-buying 'chains' is concerned" (R.86-87). Furthermore, as the Commission pointed out (R. 87):

> The startling nature of this conclusion is even more evident, however, when it is considered that those who *would* be entitled to claim the protection of Section 2(d) in this situation are the other "chains" located in the area. Thus in a geographical market served by, say, two direct-buying "chains," and one wholesaler with 100 retailer-customers, a supplier who gave a promotional allowance to Chain

> A would not be required by Section 2(d) to give it to either the wholesaler or the 100 independent retailers who buy from it, but would have to give it to Chain B. This would mean, of course, that the protection of Section 2(d) is accorded to those who presumably have the market power to take care of themselves (competing "chains"), but denied to those who, as the instant record clearly shows, need its protection very badly indeed.

It would conflict with economic reality to apply the prohibitions of section 2(d) only within descriptive functional classes such as wholesalers and retailers even in instances where, as this record shows, they actively compete with each other in the distribution of the same products. The realities of the present-day marketplace are such that functional labels such as "wholesalers," "retailers," "jobbers," "factors," and "brokers" are often not only ambiguous but meaningless and irrelevant to determination of the fact of competition in the distribution of the same products. The Supreme Court has approved the Commission's disregard of such labels in determining in Clayton Act cases whether different customers are actually competitors, *Federal Trade Commission* v. *Ruberoid Co.*, 343 U.S. 470, 475 (1952), because in any reasonable implementation of antitrust objectives, "the crucial fact is the impact of the particular practice on competition, not the label that it carries," *Federal Trade Commission* v. *Motion Picture Advertising Service Co.*, 344 U.S. 392, 397 (1953). See also *United States* v. *Masonite Corp.*, 316 U.S. 265, 280 (1942); and *Times-Picayune Publishing Co.* v. *United States*, 345 U.S. 594, 615 (1953).[23]

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[23] In noting the problems created by dual systems of distribution in connection with the enforcement of the Clayton Act, as amended by the Robinson-Patman Act, a leading antitrust commentator has recently observed (Kintner, Book Review, 64 Col. L.R. 1166, 1170 (1964):

> Many fundamental policy considerations are ignored if too great emphasis is placed on technical labeling of

The harm to competition in the distribution of products, which the Congress sought to prevent by section 2(d), is the same when wholesalers whose retailer-customers compete with direct-buying retail chains do not receive a fair share of the promotional allowances received by the latter, as it is when the discrimination is between wholesalers reselling to retailers, or between retailers. Petitioners here perform the same distribution function for their retail stores as do the wholesalers for their retailer-customers, and compete for the same consumer dollars as do the wholesalers and the retailers, as the Commission found (R. 88-90). They are, therefore, truly "competing" with both wholesalers and retailers "in the distribution of" those products, within the plain meaning of those words in section 2(d).

As the Commission found (R. 89):

> Every time an independent retailer loses a sale to [petitioners], the wholesaler who supplied that independent retailer suffers a loss of volume by just that much. And if all of the independent retailers in Portland should close their doors, these wholesalers would be finished in that market.

The ability of the more than 100 Portland independent retailer-customers of those two wholesalers to compete on an equal basis with petitioners depends on whether or not they are able to obtain through their wholesalers the

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functions within a distributive system. I feel strongly that the Commission and the courts should carefully evaluate any situation in terms of achieving a rational enforcement policy consistent with the realities of the market place.

My hope that this goal may yet be achieved was strengthened by the Commission's recent decision in the *Fred Meyer* case [footnote omitted]. * * * By focusing on the realities of the market place rather than on technical location within the ladder of distribution, the Commission promoted the statutory policy to protect independent retailers by finding the wholesaler and his customers to be in competition with direct buying chains.

benefits of proportional shares of the promotional allowances given by the suppliers.[24] As the Commission properly found (R. 89-90):

> Any competitive disadvantage experienced by the wholesaler himself in buying goods in competition with the chains is necessarily passed on to its retailer-customers. If it pays more for a given product than [petitioners] pay, the price it charges the independent retailers will naturally reflect that higher price. (One of these wholesalers, Wadhams & Co., actually sells on a "cost-plus" basis, i.e., it charges its retailer-customers the price it pays for the goods, plus a fixed percentage of that amount to cover its other costs and its profit margin.) And if the wholesaler is denied promotional allowances received by [petitioners], it obviously cannot pass them on to its retailer-customers or use them for the benefit of those customers.

Limiting the applicability of section 2(d) to customers competing at the same functional level of distribution would render that provision inconsistent with other portions of the same statute. Congress intended by the interrelationship of sections 2(a), 2(d), and 2(e) to prevent circumvention of the prohibitions of section 2(a) by use of alternatives for price discriminations. It logically follows that in any circumstance in which a price discrimination would violate section 2(a), a discriminatory allow-

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[24] While one writer would impose functional tests in determining the fact of competition (Rowe, *Price Discrimination Under the Robinson-Patman Act* (1962) at pp. 396-97), use of such criteria has been properly criticized as "too narrow." Baum, *The Robinson-Patman Act* (1964) at pp. 54-55:

> Rather, the central question should be whether competition is affected by the grant of an allowance or service to one purchaser and not another. The functional criterion in this context loses its relevancy. (See *Federal Trade Commission* v. *Morton Salt Co.*, 334 U.S. 47 (1948); and *Fred Meyer, Inc.*, Dkt. 7492 (March 29, 1963)).

See also *Kintner, supra,* 64 Col. L.R. at 1170.

ance would violate section 2(d) and a discriminatory service would violate section 2(e).

Petitioners' attempt (Brief 31-32) to derive comfort from the omission from section 2(d) of the "effects" language found in 2(a) is specious, as the extensive discussion of the matter in the Commission's opinion (R. 90-93) makes clear.

The effects language of section 2(a) specifies in detail the several levels of "competition" where competitive *injury* must be found, *regardless of the level or levels in which the discrimination occurs,* which can be elsewhere, and between customers at different "functional" levels. *E.g., Standard Oil Co.* v. *Federal Trade Commission,* 173 F.2d 210, 212, 217 (7th Cir. 1949), *rev'd on other grounds,* 340 U.S. 231 (1951); *Federal Trade Commission* v. *Morton Salt Co.,* 334 U.S. 37, 40-41, 55 (1948); *Forster Mfg. Co.* v. *Federal Trade Commission,* 335 F.2d 47, 53 (1st Cir. 1964), *cert. denied,* March 2, 1965, 33 LW 3285; In re *Fruitvale Canning Co.,* 52 F.T.C. 1504, 1508-12, 1514 (1956), *pet. to rev. dismissed,* January 30, 1957, Ninth Cir. No. 15246. And see Austin, *Price Discrimination and Related Problems Under the Robinson-Patman Act* 51-54 (2d Ed. 1959).

The decision in *Federal Trade Commission* v. *Sun Oil Co.,* 371 U.S. 505 (1963), affords additional support to the Commission's refusal to give identical meaning to the terms "competition" and "competing" at every place they appear in different contexts in the several subsections of section 2. The Commission correctly observed (R. 90) that "while 'competition' in one form or another is the concern of the several subsections of the Act, there is no universal definition of that term that can be applied mechanically to all of its provisions." Citing *Sun Oil,* the Commission further noted, as an example, that " 'competition,' as used in Section 2(b)'s 'meeting competition' proviso, refers *solely* to competition with the discriminating *seller,* i.e., to 'primary-line' competition," and properly concluded that, because "[n]one of the other subsections are so limited," "the scope of 'competition' embraced

by one of the Act's provisions is not necessarily controlling in the context of another section" (R. 90).

Petitions' reliance (Brief 33, 34) on the *Sun Oil* decision thus is clearly misplaced. That case involved the scope of the good faith meeting of competition defense, in the context of a case involving price discrimination under section 2(a), not one involving disproportionate promotional allowances under the *per se* provisions of section 2(d.) It is clear that the Supreme Court in *Sun Oil* did not intend its language respecting the scope of the section 2(b) defense in a section 2(a) case to determine the entire coverage of section 2(d).

Contrary to petitioners' assertions, it *was* squarely held in *Krug* v. *International Telephone & Telegraph Corp.*, *supra*, 142 F. Supp. at 236, that a "violation of Section 2(d) may occur when a manufacturer gives a retailer an allowance not given to a wholesaler whose customers compete with such retailer." We are unable to read the *Krug* decision as solely involving, in the words of petitioners (Brief 35), "a special application of the familiar 'indirect customer' doctrine." And we are unaware that any court or antitrust commentator has interpreted *Krug* in any other manner than as viewed by the Commission herein.[25]

We submit that the Court should reconsider this issue, and, contrary to the views it expressed in *Tri-Valley*, hold that upon proper facts, including those of this case, a wholesaler may be a "customer competing" with a retail chain "in the distribution of" a discriminating supplier's

[25] See, *e.g.*, Austin, *Price Discrimination and Related Problems Under the Robinson-Patman Act* 134-35, 137-40 (2d Ed. 1959); Rowe, *Price Discrimination Under the Robinson-Patman Act*, 397, 398-99 (1962). Compare Kintner, Book Review, 64 Col. L.R. 1166, 1170 (1964). And see 52 Geo. L.R. 195, 197 (1964).

products, within the meaning and protection of section 2(d).[26]

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[26] Petitioners also argue (Brief 36-37) that because the Commission's complaint did not allege the same legal theory upon which the Commission decided the point discussed above, there has been a fatal variance between complaint and decision. They do not, and of course cannot, assert any variance between proof and decision.

The argument is frivolous. As the Commission pointed out (R. 148-57), they had ample opportunity to develop all the relevant facts, the only issue was the proper application of the law to those facts, and petitioners had full opportunity to argue that issue. Even under the old common-law rules of pleading, only facts, and not legal theories, were required to be pleaded. Under modern notice pleading in both courts and agencies even variances between the facts alleged in pleadings and those found in decisions are not automatically fatal. As was held in *Armand Company* v. *Federal Trade Commission,* 84 F.2d 973, 974-75 (2d Cir. 1936):

> [T]he respondent [alleging variance] must maintain that the order so far abandoned the very frame and outline of the original charge that it had no greater sanction than if the bailiff had signed it. * * * At least in a contested case there must be an entire abandonment of the very substance of the dispute to which the defendant was summoned, and the substitution of another which he could not have anticipated, and which he had no opportunity to meet.

The court concluded (84 F.2d at 975) that to hold otherwise "would be to go back at least two centuries."

Accord, Carter Products, Inc. v. *Federal Trade Commission,* 323 F.2d 523, 533 (5th Cir. 1963); *NLRB* v. *Mackay Co.,* 304 U.S. 333, 349-50 (1938); *P. Lorillard Co.* v. *Federal Trade Commission,* 186 F.2d 52, 54 (4th Cir. 1950). *Cf. Tri-Valley Packing Ass'n* v. *Federal Trade Commission,* 329 F.2d 694, 697-700 (9th Cir. 1964); and Rule 15(b), Rules of Civil Procedure for United States District Courts.

D. ***The Commission's finding to the effect that petitioners were aware of the facts making illegal the discriminatory payments and allowances they induced and received from their suppliers is properly supported by the undisputed findings as to underlying facts, and by the findings petitioners challenge here, which are supported by substantial evidence***

Petitioners cite, but misunderstand, one of the court decisions closest in point on the issue of a buyer's knowledge of facts making illegal under section 2(d) discriminatory payments it induces and receives from a seller. That decision is *Giant Food Inc.* v. *Federal Trade Commission*, 307 F.2d 184 (D.C. Cir. 1962), *cert. denied*, 372 U.S. 910 (1963). It is not correct, as petitioners declare (Brief 80), that in *Giant* the court held that "a finding of unlawful inducement can only be made '. . . in circumstances where it appears that such want of knowledge on the buyer's part was culpable,' " or that "in order to find that [the buyer] acted culpably, it must be shown that good faith was lacking." Neither *Giant* nor any other decision of which we are aware has mentioned a lack of good faith as an element of proof in any case of this kind, and the court in *Giant*, instead of holding that culpable want of knowledge is the only proper basis for a finding of unlawful inducement, actually held the obverse: that the Supreme Court's *Automatic Canteen* decision (on which petitioners in *Giant* and here rely) "cannot be read to mean that a buyer can plead want of knowledge as a successful defense * * * in circumstances where it appears that such want of knowledge on the buyer's part was culpable" (307 F.2d at 184). This statement of what is not a valid defense cannot, we submit, be twisted into petitioners' distorted assertion as to what constitutes the only basis for a valid "finding of unlawful inducement." [27]

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[27] We treat petitioners' distortion of the *Giant* ruling in more detail than it individually might deserve, because it is one of the clearer examples of the manner in which they have

What the court actually held in *Giant* was plainly quite different from petitioners' version. Following the sentence we have quoted above it said (*loc. cit.*): "[T]he question becomes whether or not, upon the record as a whole, the Commission introduced enough evidence to show that Giant, at the time it induced and received the payments from its suppliers, possessed information sufficient to put upon it the duty of making inquiry to ascertain whether the suppliers were making such payments available on proportionally equal terms to Giant's competitors."

Petitioners, although citing *Grand Union Co.* v. *Federal Trade Commission*, 300 F.2d 92 (2d Cir. 1962), elsewhere on other points, fail to mention the pertinent ruling therein (at p. 100): "The record supports [the Commission's] finding that Grand Union knew, or in the exercise of reasonable care should have known, that the payments received had not been made proportionally available to its competitors." Also, although citing *American News Co.* v. *Federal Trade Commission*, 300 F.2d 104 (2d Cir. 1962), *cert. denied*, 371 U.S. 824, they fail to mention what was said there (at p. 110): "Although knowledge must be proved, it need not be by direct evidence; circumstantial evidence, permitting the inference that petitioners knew, or in the exercise of normal care would have known, of the disproportionality of the payments is sufficient."

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throughout their brief similarly twisted and distorted almost every part of the record and every court and Commission decision, when to do so has suited their arguments. Because of those consistent and all-pervading distortions, we have found it impossible within time and page limitations to answer all of them, relevant and irrelevant, and therefore have mentioned only the more important and representative. We request the Court, therefore, not to construe our silence as to anything said on any subject anywhere in petitioners' brief as acquiescence in petitioners' version of fact or law.

Relying upon those precedents affirming its prior decisions, the Commission in this case found (R. 117) that petitioners "possessed more than enough 'information to put upon [them] the duty of making inquiry' as to whether or not their participating suppliers were taking steps to make those promotional payments available to other buyers." The Commission based that finding upon additional findings (which petitioners neither specify as error nor argue are not supported by substantial evidence) that (1) "it was [petitioners], not the suppliers, who originated or initiated the programs under which the concessions were granted," (2) "when they conceived these plans and presented them to their suppliers, [petitioners] thereby began to receive payments other buyers necessarily could not have been enjoying at that moment," and (3) in order to make the same concessions available to all other buyers, the suppliers in question would have therefore had to initiate, subsequent to [petitioners'] solicitation, a program based on, or including as one of its alternative features, the arrangement with [petitioners]" (R. 117-18).

The Commission then made the ruling which petitioners erroneously attack (Brief 81) as unprecedented and wrong: "We think the law is plain that a buyer who initiates a promotional service and induces his supplier to pay him for performing it has possessed himself of 'information sufficient to put upon it the duty of making inquiry to ascertain whether the suppliers were making such payments available on proportionally equal terms to [his] competitors'" (R. 118). The Commission then, drawing upon its expertise in this field, made the following findings concerning the realities of the marketplace context in which such solicitations and payments occur: (1) "the natural reaction of a supplier who has yielded to the demands of one of his larger customers is not to further lighten his purse by making the same payments to hundreds of others, but to minimize his outlay by concealing the fact that he has made any such payment at all," (2) "a powerful buyer does not go to a seller with hat in

hand asking to be given something that is 'proportionally equal' to what the smaller buyers are getting; he wants something *in addition* to what the others are receiving," and (3) "the result is almost invariably a situation in which the initiating buyer continues to receive the same promotional allowances all other buyers are receiving, plus the new one he has conceived himself" (R. 118). Petitioners do not specify any of those findings as error, or argue that they are not properly based upon the Commission's expertise in this field. They are self-evidently correct, as this Court properly may assure itself from facts concerning human nature and commercial practices within the scope of its own judicial knowledge.

We submit that the Commission's ruling is correct, and should be affirmed. Petitioners are in error in asserting (Brief 81-82) that it is unprecedented, that it conflicts with the Supreme Court decision in *Automatic Canteen Co.* v. *Federal Trade Commission* 346 U.S. 61 (1953), and that it improperly requires the buyer to assume that its suppliers are guilty of illegal behavior.

First, the ruling is not unprecedented, but follows logically from the *Grand Union*, *American News*, and *Giant Food* decisions. More importantly, in *R. H. Macy & Co.* v. *Federal Trade Commission*, 326 F.2d 445, 450 (2d Cir. 1964), where the evidence showed that Macy's had induced and received discriminatory special-occasion payments from its suppliers, the court held that "once the Commission proved that special payments had been made only to Macy's, the burden of coming forward with evidence that similar payments were available to Macy's competitors * * * was on Macy's."[28] That ruling goes further than but includes the Commission's in this case; the burden of proving availability cannot be carried without first ascertaining availability.

Second, the Commission's ruling does not conflict with

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[28] Macy's was represented by the firm of Howery, Simon, Baker & Murchison, petitioners' principal counsel in this case. The *Macy* decision is highly relevent upon this and other points petitioners argue, yet they have not even mentioned it.

Automatic Canteen. That decision was concerned with proof of the buyer's knowledge under section 2(f) of the *absence* of elements of the sellers' affirmative *defenses* to charges of violations of section 2(a), rather than his actual or imputed knowledge of the *presence* of elements of the sellers' offenses under either that section or 2(d), and no rulings were made therein on the latter problem. Furthermore, as the court held in *American News, supra,* 300 F.2d at 111, "there is nothing in the Supreme Court's opinion in *Automatic Canteen* * * * which precludes the imposition of a duty of reasonable inquiry upon a buyer."

Third, the Commission's ruling does not conflict with the rule applicable in determining rights between parties to civil suits, one of which has relied to his injury upon an assumption as to the honesty and legality of the actions of the other, as in *Fidelity & Deposit Co.* v. *Grand National Bank of St. Louis,* 69 F.2d 177, 183 (8th Cir. 1934), which petitioners cite (Brief 82). The Commission's ruling plainly does not require buyers to assume any illegality; it merely requires them, when they have in their possession facts indicating possible illegality, not to ignore them. That requirement is not novel; it has long been the law that "everyone is presumed to know everything he can learn upon inquiry, when he has facts in his possession which suggest inquiry," and that he "must be charged with knowledge of that which it was his duty to know." *United States* v. *Pearson,* 62 F. Supp. 767, 769 (N.D. Cal. 1945). *Accord, Metropolitan Bag & Paper Dist. Ass'n, Inc.* v. *Federal Trade Commission,* 240 F.2d 341, 344 (2d Cir. 1957), *cert. denied,* 355 U.S. 819; *Phelps Dodge Refining Corp.* v. *Federal Trade Commission,* 139 F.2d 393, 396 (2d Cir. 1943). "A man is presumed to know what a reasonable person ought to know from facts brought to his attention," and cannot "close his eyes to the obvious." *Avery* v. *Commissioner of Internal Revenue,* 22 F.2d 6, 7 (5th Cir. 1927).

In this case there can be no doubt that either petitioners received information that their contributing suppliers were selling the same products to petitioners' competi-

tors and not making similar payments to them, or would have received such information had they inquired. The undisputed findings quoted above would therefore be entirely sufficient, standing alone, to support the Commission's finding that petitioners were aware they were inducing and receiving discriminatory payments.

But that evidence does not stand alone. The Commission found (R. 119), and petitioners do not dispute here, that the coupon-book participation contracts contained the provision: "Offer Must Be Exclusive at Fred Meyer During the 4 Week Period." The Commission found (R. 120) that this mean that "each supplier who participated in [petitioners] 'coupon book' promotion agreed with [petitioners] that it would not, during that particular four-week period of time, 'participate' in a similar program sponsored by any other buyer." Petitioners do not dispute that finding here, but argue (Brief 83) that there is no evidence that the contractual requirement was carried out. But the provision itself is such evidence, and it is unrefuted by anything in the record. It shows petitioners' purpose to obtain the discriminatory payments it did in fact receive. Petitioners cannot be heard now to deny that they were aware that they were receiving the very discriminatory preferences which they demanded. "It may fairly be assumed that one who has reason to believe a fact exists, knows it exists." *Shaw* v. *Railroad Co.*, 101 U.S. 557, 566 (1879).

As against all of this petitioners offer (Brief 86-90) only a few selected scraps of testimony, such as that of their buyer who purchased from Tri-Valley and Idaho Canning (R. 86) to the effect that he did not question Tri-Valley about other customers or prices, and that he did not know what other customers those two sellers had in the Portland area. That is irrelevant, as we have shown above. But in addition, it tells us nothing about awareness of other persons in the management of the corporate petitioner, or of the individual petitioners. Most importantly of all, however, the argument consists only of an

attempt to persuade this Court that those scraps are credible, are probative, and outweigh and refute all of the rest of the evidence concerning petitioners' knowledge, which the Commission relied upon in making its findings (R. 103-30).[29] Petitioners do not and cannot deny that that evidence logically permits the inferences which the Commission drew from it. They do not and cannot contend that their scraps of testimony so completely refute that evidence as to compel the drawing of contrary inferences. They candidly admit (Brief 8) that their argument is that the Commission made the findings they attack by "misconstruing the evidence." In effect, therefore, they have admitted the legal substantiality of the evidence supporting the findings, but want this Court to decide that it was less authoritative and less persuasive than their scraps. Such matters are not properly argued to a court of appeals in an appellate review proceeding of this kind. *Stauffer Laboratories, Inc.* v. *Federal Trade Commission*, Ninth Circuit No. 19,279, February 17, 1965 (slip op. p. 7). This Court's decision in *Esco Corporation* v. *United States*, No. 19,348, January 20, 1965 (slip op. p. 11), is pertinent. As in that case, even if the evidence did not compel the inferences drawn by the Commission (which they plainly did), it cannot be said that, as a matter of law, contrary inferences are compelled. As a result, to paraphrase what this Court said there, "it remains a question for the trier of fact to consider and determine what inference appeals to it [the Commission] as most logical and persuasive, after it has [considered] all the evidence" relevant to the factual issue, and petitioners' argument "is more appropriately made to [the Commission] than to an appellate court."

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[29] The evidence cited and principally relied upon by the Commission in making those findings appears in the record at pages 191-95, 200, 207-9, 212-21, 226-30, 238-39, 473, 478-96, 498-505, 551, 556.

We submit that petitioners have failed completely to demonstrate any error in the Commission's findings of fact or rulings of law concerning their knowing inducement and receipt of illegal payments and allowances, and that its decision as to that matter therefore should be affirmed.

III. The Commission correctly determined that petitioners have violated section 2(f) of the amended Clayton Act by knowingly inducing and receiving price discriminations prohibited by section 2(a) of that Act

A. *Because of a subsequent Commission decision in a related case involving,* inter alia, *the same price discriminations by Cannon Mills Company involved in this case, we do not rely upon those price discriminations in this review*

The Commission concluded that petitioners have violated section 2(f) of the amended Clayton Act by soliciting and receiving from their suppliers price discriminations in their annual four-week coupon-book promotions and sales. The four suppliers whose transactions in the 1956, 1957, and 1958 sales were studied as representative were Tri-Valley, Idaho Canning, Burlington Industries, and Cannon Mills. As to each of these the Commission found the presence of all elements of violations of section 2(a) by the seller, the absence of all of the affirmative defenses available to the seller, and petitioners' awareness thereof.

The Commission's final action in this case was taken on July 9, 1963. At that time there was pending before the Commission a proceeding in which Cannon Mills was charged with having violated section 2(a) by, *inter*

alia, granting to petitioners the same price discriminations involved in this case (In re *Cannon Mills Company*, Docket 7494). On April 24, 1964, after the petition for review in this case had been filed in this Court, and after the Commission had lost jurisdiction in this case by certifying its record to this Court, the Commission rendered its final decision in the *Cannon Mills* case. In that decision it found that "the evidence of record is insufficient to prove the requisite adverse effects on competition," and dismissed the proceeding.[30]

Although we believe that it is a valid principle of law that each case should stand upon its own record, and that the record in this case contains evidence sufficiently substantial to support the Commission's finding as to competitive injury resulting from the Cannon Mills discriminations, we believe that in equity petitioners should have the benefit in this case of the Commission's determination, in *Cannon Mills*, that the similar evidence in that record did not constitute the preponderance, even though issues as to the greater weight of evidence are not open for redetermination in appellate review proceedings such as this.

Accordingly, while we rely upon Cannon Mills' discriminations as constituting violations of section 2(d), as we have argued above, we do not rely upon its price discriminations as constituting violations of section 2(a), or upon their inducement and receipt by petitioners as constituting violations of section 2(f).

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[30] The case was before the Commission for its *de novo* review of the record and the examiner's initial decision. The examiner had held that a *prima facie* case had been proved, including the requisite probability of anticompetitive effects, but had upheld Cannon Mills' affirmation defense of cost-justification. The Commission vacated the decision because of the lack of a *prima facie* case, and therefore did not "reach the merits of respondent's cost-justification defense." 3 CCH Trade Reg. Rep. ¶ 16,878. For convenient reference a copy of the Commission's final order is printed in appendix "C" of this brief, pp. 6b-7b.

B. *The Commission correctly determined that petitioners' suppliers have violated section 2(a) of the Clayton Act by discriminating in price between petioners and their competitors, and that petitioners were aware of the facts making those discriminations illegal*

A breakdown of the provisions of section 2(a) of the Clayton Act shows that to support a ruling that a supplier has violated that section it must be properly found that—

(1) the supplier is engaged in commerce, and in the course thereof

(2) discriminated in price

(3) between different purchasers

(4) of commodities of like grade and quality

(5) where the effect may be

- (a) substantially to lessen competition or tend to create a monopoly in any line of commerce
- (b) or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them.

A breakdown of section 2(f) shows that in cases brought against a buyer all of those factors must be properly found, plus the facts that—

(6) the buyer induced or received the discriminations

(7) knowing the facts which made them illegal.

In addition, in cases brought under section 2(a) discriminating sellers are allowed to prove certain affirmative defenses. The Supreme Court, in *Automatic Canteen, supra*, 346 U.S. at 74, held that "a buyer is not liable under § 2(f) if the lower prices he induces are either within one of the seller's defenses such as the cost justification or not known by him to be within one of those defenses." The Court further held that in proceedings under section 2(f) proof of the absence of cost justification

and of the buyer's awareness thereof is a part of the affirmative case, rather than of the buyer's defense.

The Commission made findings as to all of those elements of proof with respect to the participations by Tri-Valley, Idaho Canning, and Burlington Industries in petitioners' 1957 and 1958 coupon-book promotions and sales.

Petitioners' specify as error (Brief 7, sp. 1) the Commission's finding and ruling that the price cuts and rebates they received from those suppliers constituted price discriminations within the coverage of section 2(a), and argue (Brief 16-26) that they were discriminations in payments for services within the exclusive coverage of section 2(d).

They do not specify with particularity any of the other findings as error. They argue, however (Brief 78-79), that solely because their coupon-book sales occurred but once each year the finding of probable competitive injury is erroneous. They also argue (Brief 46-48, 56-58) that the evidence does not support the findings that the products Tri-Valley and Burlington Industries sold to them and their competitors were of like grade and quality, nor (Brief 85-89) the finding that they were so aware. They assert that the evidence does not prove that the discriminations of Burlington Industries (Brief 52) or Idaho Canning (Brief 61) were not cost justified or that they were so aware, and also (Brief 70-78) that the evidence does not prove that they were aware that any of the sellers' discriminations were not cost justified. Each of those arguments is fallaceous, as we shall show below.

1. **The Commission properly determined that the price cuts and rebates petitioners induced and received from Tri-Valley, Idaho Canning, and Burlington Industries were "discriminations in price" within the meaning and coverage of section 2(a)**

Petitioners, disregarding the undisputed findings and the evidence, and completely misunderstanding the authorities, argue (Brief 16-26) that the price cuts and rebates they received from their suppliers cannot be con-

sidered price discriminations, as found by the Commission (R. 69-74), but must be considered to be *only* discriminations in payments for services and *solely* within the coverage of section 2(d).

In the first place, the coverages of sections 2(a) and 2(d) are not mutually exclusive, so that even if it were possible to agree that the discriminations were for services rendered by petitioners to the suppliers (which plainly they were not), that would not alone preclude their also constituting price discriminations illegal under 2(a) as well. "The discriminatory payments for and furnishing of merchandising services prohibited by Sections 2(d) and 2(e) may or may not amount to indirect price discriminations within the meaning of Section 2(a). When they do, they are within the reach of both sections." Austin, *Price Discrimination and Related Problems Under the Robinson-Patman Act* 126 (2d Ed. 1959). *Cf. Elizabeth Arden Sales Corp.* v. *Gus Blass Co.*, 150 F. 2d 988, 990, 993 (8th Cir. 1945), *cert. denied,* 326 U.S. 773; *Sun Cosmetic Shoppe* v. *Elizabeth Arden Sales Corp.*, 82 F. Supp. 687, 688 (S.D.N.Y. 1949), *rev'd on other grounds*, 178 F.2d 150 (2d Cir. 1949). We are not aware of any decisional or other authority to the contrary, and that includes all the decisions upon which petitioners rely. Such overlapping coverage is consistent with the Congressional purpose. See, *e.g.*, H. R. Rep. 2287, 74th Cong., 2d Sess 15-16 (1936); 80 Cong. Rec. 9418 (1936).[31]

This overlap of the coverage of the two sections makes futile petitioners' attempt to support an accusation "that

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[31] Petitioners seem to be suggesting (Brief 17-18) that post-sale rebates, such as those by which Tri-Valley and Idaho Canning accomplished their discriminations, cannot be considered as elements of price. But the outlawing of precisely such discriminatory rebates was one of the purposes of the Clayton Act and of the Robinson-Patman amendments. See, *e.g.*, 80 Cong. Rec. 8104, 8111, 8112, 8113, 8121, 8126, 8127, 8132 (1936), where every speaker condemned them—even those who otherwise opposed the amendments. *Cf. American Can Co.* v. *Ladoga Canning Co.*, 44 F.2d 763, 767-70 (7th Cir. 1930), *cert. denied,* 282 U.S. 899.

the Commission has arbitrarily catagorized certain portions of the challenged transactions solely for the purpose of supporting an order against petitioners" (Brief 24), by making erroneous accusations to the effect that in separate proceedings against the same suppliers it has determined that the very same discriminations were "within the purview *only* of section 2(d)" (Brief 24-25); that in the case of Tri-Valley it "specifically found" that they "constituted promotional payments within the meaning of section 2(d)" and defended that finding in this Court, which upheld it (Brief 25). Although the overlap would make those statements irrelevant even if true, we must point out that they are incorrect.

Petitioners cite as one such case (R. 24) that against Cannon Mills, Docket 7494. But in that case the same price cuts as those involved in this case were attacked as price discriminations, as the Commission's final order dismissing the action makes clear, and as petitioners elsewhere in their brief (pp. 26, 79) reveal that they are well aware.

They also cite In re *Idaho Canning*, Docket 7459. That decision is reported at 58 F.T.C. 657 (1961), and in it, as in this case, the $350 was alleged as a 2(d) violation and the rest as a 2(a) violation, and the order, issued on consent without findings of violations, was similarly drafted.

The *Burlington Industries* proceeding, Docket 7493, which petitioners cite (Brief 24) was brought only against promotional-payment discriminations, and also was settled on consent, without decision by the Commission of the issues as to the violation. 56 F.T.C. 1105 (1960).

Petitioners cite only one of the two *Tri-Valley* proceedings before the Commission, Docket 7476. The other was Docket 7225. They were consolidated for hearing and decision by the Commission, and are reported together at 60 F.T.C. 1134 (1962). The Docket 7225 proceeding involved price discriminations under section 2(a), and the other involved discriminatory allowances under section 2(d). Although Paragraph 5 of the complaint in

the latter case alleged both the $350 and the remainder to support the charge of 2(d) violation (60 F.T.C. at 1137-38), the decision was otherwise. In his consolidated initial decision in both proceedings (60 F.T.C. at 1138-68) the examiner found *only* the $350 payment constituted a 2(d) violation (finding 34; F.T.C. at 1146-47). When before the Commission for its *de novo* review Tri-Valley contended that the examiner's finding (as to the $350) was error (60 F.T.C. at 1173-74), arguing that it was a price rather than a service-payment discrimination. It was that argument which the Commission rejected, and which this Court, on review, rejected also, 329 F.2d at 708. There was no finding about, and there was no argument about, the rest of the Tri-Valley discriminations involved in this case, then or thereafter, before the Commission or in this Court.

Petitioners' accusations of unfairness by the Commission thus are plainly unwarranted. We submit that upon the obvious facts concerning the circumstances of those three suppliers' transactions, the Commission was correct in holding them to be price discriminations.[32]

2. The Commission's finding to the effect that the price discriminations petitioners induced and received might adversely affect competition is not rendered invalid by the circumstance that petitioners' coupon-book sales occur only once each year

The only attack petitioners make upon the Commission's determination as to the probability of adverse competitive effect resulting from the price discriminations they induced and received from Tri-Valley, Idaho

[32] Petitioners' contentions appearing at pages 20-23 of their brief are all irrelevant here, since they ignore the findings completely, as well as the evidence upon which they were based, and consist only of an attempt to persuade this Court that selected items of evidence support the inferences petitioners wish the Court to substitute for the Commission's findings.

Canning, and Burlington Industries, consists of the accusation that the Commission has "ignored entirely" the fact that they were "once-a-year" occurrences (Brief 78), and the unargued assertion (Brief 78-79) that because of that fact, the adverse effect "must necessarily have been temporary and minimal, and insufficient to support a finding of violation of 2(a)," citing *American Oil Co.* v. *Federal Trade Commission*, 325 F.2d 101, 106 (7th Cir. 1963), *cert. denied*, 377 U.S. 954.

In the first place, the Commission did not "ignore entirely" the fact that petitioners' coupon-book promotion sales occur every year. It explicitly noted that fact, and then found (R. 123-24): "we must assume that [petitioners] have not acted arbitrarily or capriciously in selecting, for the past 25 years or more, a four-week period that begins in September and ends in October." "The inference is plain that [petitioners] themselves regard this as the most propitious season of the year for staging this particular type of promotion. Accordingly, we must conclude that a competitor, even if permitted to use the coupon book program in, say, July, would not get the same results per dollar of expenditure that [petitioners] get in September and October."

The Commission did not follow those findings with a discussion of the precise issue petitioners now try to raise, but only because petitioners did not raise it before the Commission.[33] The *American Oil* decision, *supra*, upon which petitioners place their entire reliance, involved a factual situation quite different from petitioners' annual sales. In that case the discriminations occurred in a retail gasoline price war which was not started by American and which lasted less than three weeks. The core of the

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[33] *Cf. United States* v. *Tucker Truck Lines*, 344 U.S. 33, 36-37 (1952); *DeGorter* v. *Federal Trade Commission*, 244 F.2d 270, 272 (9th Cir. 1957); *Barclay Home Products* v. *Federal Trade Commission*, 241 F.2d 451, 452 (D.C. Cir. 1957), *cert. denied*, 354 U.S. 942 (1957); *Halstead* v. *Securities & Exchange Comm'n*, 182 F.2d 660, 669 (D.C. Cir. 1950).

decision was that, the court felt, the price war was over before any real injury had occurred, since it was over no further injury was probable, and because of low prices by other major-brand stations the injury would have occurred even if American had not discriminated (325 F.2d at 104-106). None of those factors is present in this case, and the court in *American Oil* explicitly distinguished the two types of situations, 325 F.2d at 106.

3. Substantial evidence supports the Commission's findings to the effect that the price discriminations petitioners induced and received from Tri-Valley, Idaho Canning, and Burlington Industries did not "make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered," within the meaning of section 2(a) of the Clayton Act, and that petitioners were so aware

In *Automatic Canteen, supra*, 346 U.S. at 79-81, the Supreme Court held that in a case against a buyer under section 2(f) it is the Commission's burden to produce evidence tending to show that discriminations he induced or received were not cost-justified, and that he was so aware. It then discussed types of evidence which would suffice to support findings as to both those facts. We believe that what it said is so significant here as to warrant direct quotation (with emphasis and footnote comments supplied):

> If the requirement of knowledge in § 2 has significant function, it is to indicate that the buyer whom Congress in the main sought to reach was the one who, knowing full well that there was *little likelihood* of a defense for the seller, nevertheless proceeded to *exert pressure* for lower prices.[34] Enforce-

[34] Petitioners correctly acknowledge (Brief 69) that "proof that a buyer coerced its suppliers to grant price concessions

ment of the provisions of § 2(f) against such a buyer should not be too difficult. Proof of a cost justification being what it is, too often no one can ascertain whether a price is cost-justified. But *trade experience in a particular situation can afford a sufficient degree of knowledge* to provide a basis for prosecution.[35] By way of example, a buyer who knows that

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may well estop the buyer from claiming that it lacked knowledge or reason to believe that the concessions received were unlawful." "Such inducement of concessions would obviously have occurred under circumstances which rendered the buyer's claimed lack of knowledge culpable." But they are in error in asserting (*loc. cit.*) that no such circumstances are involved in this case. The Commission made findings showing that petitioners coerced Idaho Canning into granting its 1957 price discriminations. It found (R. 132) that while petitioners' 1957 sales were over $40 million, Idaho Canning's were only slightly over $1 million. It found (R. 113-14) that petitioners approached that supplier about the matter early in 1957, that Idaho did not agree to grant the discriminations and did or said nothing to lead petitioners to believe that it had agreed, but petitioners nevertheless featured an Idaho Canning product in their 1957 sale and thereafter billed it $350 for the coupon-book page and $2,953.41 for the 1/3 cut in price. It found that Idaho denied the debt and returned the bill to petitioners, and thereafter petitioners deducted the total from a payment to Idaho, that Idaho protested and petitioners returned the money to Idaho, but a few months later Idaho yielded and shipped to petitioners $2,935.41 worth of free goods. The Commission also found (R. 115-16) that petitioners were "less than candid" about this at the hearing.

Those findings clearly show coercive pressures by petitioners upon that supplier, and petitioners neither specify them as error nor argue that they lack substantial evidentiary support. They are, under the familiar principles of law which petitioners acknowledge (Brief 69) sufficient to charge petitioners with full knowledge of the illegality of the discriminations they coerced from Idaho, and to warrant the inference that other suppliers' grants were not entirely voluntary.

[35] Trade experience more informative than petitioners' can scarcely be imagined. The Commission found that the corpo-

he buys in the same quantities as his competitor and is served by the seller in the same manner or with the same amount of exertion as the other buyer can fairly be charged with notice that a substantial price differential cannot be justified. The Commission need only show, to establish its prima facie case, that the buyer knew that the methods by which he was served and quantities in which he purchased were the same as in the case of his competitor. If the methods or quantities differ, the Commission must only show that such differences could not give rise to sufficient savings in the cost of manufacture, sale or delivery to justify the price differential, and that the buyer, knowing these were the only differences, *should have* known that they could not give rise to sufficient cost savings. The showing of knowledge, of course, will depend to some extent on the size of the discrepancy between cost differential and price differential, so that the two questions are not isolated.[36] A showing that the cost differences are very small compared with the price differential should be sufficient.

What other circumstances can be shown to indicate knowledge on the buyer's part that the prices

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rate petitioner owns and operates 13 supermarkets in the area, that its 1957 sales exceeded $40 million, that it sells one-fourth of all food sold at retail in that area and is the second largest seller of all goods therein, that it sells to 75% of Oregon's population and has one supermarket in every neighborhood (R. 60). It found that the coupon-book promotion and sale has been used since about 1936 (R. 62). It found that the individual petitioners are Chairman and President of the corporation (R. 61), that they knew about and authorized the practices, and that the individual petitioner Meyer had been in the industry 50 years (R. 137). Petitioners have neither specified any of those findings as error nor argued that they are not supported by substantial evidence.

[36] It was because of this fact that the same factors which indicate the lack of cost-justification also indicate the buyer's knowledge thereof, that the Commission considered both issues simultaneously (R. 130-36).

> cannot be justified we need not now attempt to illustrate, but surely it will not be an undue administrative burden to explain why other proof may be sufficient to justify shifting the burden of introducing evidence that the buyer is or is not an *unsuspecting recipient* of prohibited discriminations.[37]

Petitioners' argument concerning cost-justification suffers from several defects. First, they erroneously state (Brief 68-69) that the types of factors which the Supreme Court listed as sufficient "defined" the "burden of proof," overlooking the fact that the Court gave them only "by way of example," and clearly indicated that there were "other circumstances" which would also be sufficient. Second, they again ignore the findings and the evidence supporting them, and argue the meaning, credibility, and weight of parts of the evidentiary record, in support of proferred inferences contrary to the findings.[38] Third, they completely fail to mention the finding to the effect that even if there had been cost savings to the sellers in the coupon-book transactions, they would have been the *result* of the special-occasion discriminations, not their *cause*, and fail to mention the Commission ruling to the effect that such *resulting* savings cannot be used to justify their *generating* discriminations (R. 132-33).

The Commission found (R. 131) that "none of the suppliers in question grant quantity discounts." "All buyers, regardless of the quantity in which they purchase from

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[37] Nothing in this record of petitioners' active and persistent demands for and receipt of large and exclusive special-occasion discriminations could possible warrant, let alone compel, the inference that they were mere *"receipients"* of the discriminations, nor that they were *"unsuspecting"* of their illegality; the evidence overwhelmingly shows the opposite.

[38] *E.g.*, petitioners' brief, p. 76, n.47, where petitioners' argument in support of an asserted fact concludes: "An inference to this effect is as well founded as the Commission's inference to the contrary."

the four sellers in question, pay the same invoice price (except for the concessions found unlawful here)." It also found that petitioners' memorandum of their coupon-book agreements contains entries of the regular prices of the suppliers' products and their special prices for the coupon-book sales. Petitioners do not specify those findings as error or argue that they are not supported by the evidence.

Based largely upon those facts, the Commission found (R. 131-32) that petitioners "pay, during eleven months out of the year, the same price that every other buyer pays," and "after the one-month period of the coupon book promotion ends, they go back to paying that higher price." Petitioners do not specify that inferred finding as error, nor argue that the undisputed findings do not make it permissible. Their only attack upon it consists of the irrelevant and incorrect assertion that there is no direct evidence on the point (Brief 76, n. 47).[39] The fact of the matter is that petitioners' broker gave such evidence (R. 123-24), as did the non-favored buyers (R. 271-73, 445-56).

From these facts the Commission drew an inference that petitioners' purchasing in larger quantities than their competitors does not generate "any measurable cost savings for those sellers." Petitioners do not specify that finding as error, and do not argue that it is not supported by substantial evidence. Their only attack upon it consists of a speculation that "it is entirely possible that there were in fact cost savings which would have entitled

[39] Petitioners irrelevantly declare (Brief 75) that there is no evidence which indicates that their purchases during the rest of the year involved quantities as large as those purchased for the sale. But petitioners had in their possession full evidence on that point, if it existed, so its absence from the record does not refute the inference, but strengthens it instead. *Mammoth Oil* v. *United States,* 275 U.S. 13, 52 (1927). *Cf. Vanity Fair Paper Mills* v. *Federal Trade Commission,* 311 F.2d 480, 485-86 (2d Cir. 1962).

Fred Meyer to lower prices during" the rest of the year, and the claim that "an inference to this effect is as well founded as the Commission's inference to the contrary." The request for a substitution of one "well founded" inference for another is plainly misaddressed to an appellate court.

Having thus found that there were no justifying cost savings generated by differences in the *quantities* in which the products were sold or delivered to petitioners for their coupon-book sale, the Commission turned to the matter of possible differences in costs resulting from differing *methods* by which the commodities may have been sold or delivered to them.

It found (R. 133), based upon testimony by petitioners' officials, that "every feature of their purchasing from the suppliers in question remained precisely the same during the various one-month periods of the coupon-book promotions as during the remaining eleven months of the year (methods and terms of shipment remained the same, purchasing through the broker continued, and so forth)." [40]

In attempted refutation of those findings petitioners rely upon the fact (Brief 71) that in one order in September 1957 they purchased 3,967 cases of corn from Idaho Canning for the 1957 sale, and that Hudson House purchased only 2,200 cases in six transactions during August-October 1957, while Wadhams & Co. purchased only 80 cases in three orders during August and September, and erroneously state (Brief 72) that *Automatic Canteen* held that "no inference of guilty knowledge is permissible unless the evidence shows that the allegedly favored and disfavored customers purchased in substan-

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[40] The Commission cited testimony by Vanover, petitioners' head grocery buyer supervisor at the relevant time (R. 192), familiar with the transactions (R. 192-93). He testified to the effect that there was no change whatsoever in the methods by which the products of Tri-Valley and Idaho Canning were sold or delivered to petitioners (R. 220-22).

tially the same quantities." *Automatic Canteen* plainly did not so hold, and the witness Moss (general manager of Idaho Canning; R. 473-74) gave testimony showing that from that seller's viewpoint petitioners and Hudson House purchased substantially the same quantities of its products (R. 497).

Those facts clearly warrant the inference that the price discriminations, amounting in the case of Tri-Valley and Idaho Canning to 33⅓%, were not cost justified. Those who, as petitioners did, coercively obtain from a reluctant seller such as Idaho Canning, such a large concession, with complete and reckless indifference to the question of whether it could be cost justified, cannot now be heard to claim ignorance of the truth they could have discovered from information so readily available to them.

In addition to relying upon the affirmative evidence which shows petitioner's actual awareness, we submit that where, as here, price discriminations are not merely offered by the seller and accepted by the buyer, but actively sought by a buyer who has and knows that he has a strong bargaining position, he has the duty under the law to inquire of his seller whether the discriminations he is demanding are cost-justified by the methods or quantities in which the seller serves him, and the burden, in any section 2(f) proceeding, of producing evidence that he did so inquire, and what answer he received, if any. Nothing in *Automatic Canteen* precludes application of such a rule; indeed the Court in that case said (346 U.S. at 78) that "ordinary rules of evidence were to apply," and it indicated that its list of means of proving a buyer's knowledge was not intended to be exclusive, saying (at 79-80) "what other circumstances can be shown to indicate knowledge on the buyer's part that the prices cannot be justified we need not now attempt to illustrate." And as the court held in *American News*, *supra*, 300 F.2d at 111, "there is nothing in [*Automatic Canteen*] which precludes the imposition of a duty of reasonable inquiry upon a buyer." "Indeed, that opinion stated that the Commission might find knowledge under

§ 2(f) that payments induced and received were not cost-justified (the issue there) if it showed two things: first, that the buyer knew of a price differential, and, second, that one familiar with the trade should know that such a differential could not be cost-justified."

Furthermore, as the Commission found (R. 119-20), petitioners' contract with those suppliers provided that the arrangement under which those suppliers' products were sold at greatly reduced prices to petitioners for resale during the coupon-book sale, would be exclusive during the 4-week period. Thus even if petitioners' sales had increased so much during that period that their increased purchases had produced cost savings to the suppliers, the contract prevented the sellers from entering into similar arrangements with petitioners' competitors which might have enabled them to increase their sales and cost-justify the same price-cuts by the suppliers. As a result, it cannot be said that the discriminations from which petitioners benefited were caused by differentials in costs resulting from the quantities in which they purchased, because what in fact happened is just the reverse. The claimed differentials in sales and in costs, if they existed, would have resulted from the price discriminations which petitioners demanded and received.

Buyers cannot, we submit, demand and obtain large price discriminations, use them to increase the volume of their sales and purchases, then claim that the increase resulted in cost savings justifying the discriminations. That would not only be to put the cart before the horse, but would defeat enforcement of sections 2(a) and 2(f) entirely, by allowing special-event price discriminations to justify themselves. This, as the Commission held (R. 132-33), is not allowed by the cost-justification proviso in section 2(a).

Furthermore, the fact that those discriminations were the result of special concessions to one purchaser, rather than of a program by which the sellers varied their prices to all customers in accordance with quantities purchased and cost-savings thereon, is an additional reason why

they are outside the protection of the cost-justification proviso. Where, as here, the opportunity to obtain the lower price by purchasing in larger quantities at one time is granted to one buyer by contracts which expressly give him the "exclusive" privilege of doing so, the cost-justification proviso is inapplicable. *Alhambra Motor Parts* v. *Federal Trade Commission*, 309 F. 2d 213, 216 (9th Cir. 1962). This distinction is necessary to prevent evasion, for otherwise, as here, discriminations could be cost-justified simply by not letting the unfavored competitors konw of the availability of quantity discounts, or by otherwise making unavailable to them price cuts based on such cost savings, as, *e.g.*, in *American Can Co.* v. *Ladoga Canning Co.*, 44 F.2d 767-70 (7th Cir. 1930), *cert. denied*, 282 U.S. 899. *Cf. Mueller Co.* v. *Federal Trade Commission*, 323 F.2d 44, 46 (7th Cir. 1963), *cert. denied*, 377 U.S. 923.

Finally, the record leaves no doubt that when petitioners demanded and received the discriminations, they did not claim them as something to which they were entitled by reason of cost savings resulting from larger purchases, but demanded them solely to underwrite their special sales. It also leaves no doubt that when the suppliers acceded to those demands, they did not do so because of any belief they were justified by cost savings, but solely to placate a powerful buyer. That which was, when granted, a discrimination not even attempted to be based upon cost savings, cannot subsequently be "artifically tailored" into one "by fitting it to some imaginary basis or standard that has never in fact existed." *Cf. Elizabeth Arden Sales Corp.* v. *Gus Blass Co.*, 150 F.2d 988, 994 (8th Cir. 1945), *cert. denied*, 326 U.S. 773.

For the foregoing reasons we submit that the record fully supports the Commission's determinations to the effect that the price discriminations petitioners actively induced and received from Tri-Valley, Idaho Canning, and Burlington Industries on its purchases of their products for its coupon-book sales were not "differentials which [made] only due allowance for differences in the cost of

manufacture, sale or delivery resulting from the differing methods or quantities in which such commodities [were] to [petitioners] sold or delivered," within the meaning of that exemption in the Clayton Act, and that petitioners knew or should have known that fact.

IV. The Commission's inclusion of the individual petitioners, by name, in its order to cease and desist, and its inclusion in the prohibition against inducing and receiving discriminatory payments of a phrase making explicit its valid application to discriminations between petitioners and wholesalers competing with them, was not an abuse of discretion

Most of petitioners' attack upon the Commission's order is misdirected, since it consists merely of criticisms of specific phrases used by the hearing examiner in his proposed order (Rr. 53-54), which the Commission did not include in the order it drafted and issued (Apdx B). For those reasons we believe it is unnecessary to respond in detail to the erroneous assertions as to the nature of rulings in various court decisions, with which petitioners have attempted to support their moot criticisms.[41]

The only arguments which are not misdirected are those criticizing the order's specific reference to the individual petitioners (Brief 95-96) and to competing wholesalers (Brief 102). The latter contention, however, is not really a criticism of the order as such, but of the Commission's ruling as to the law's application, which petitioners recognize by their failure to urge that the provision should be deleted even if the Court agrees with the Commission's ruling.

Petitioners' contention that the order should not apply to the individual petitioners is plainly without merit. As

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[41] This Court's decision in *Western Fruit Growers Sales Co.* v. *Federal Trade Commission,* 322 F.2d 67, 69 (1963), *cert. denied,* 376 U.S. 907, which petitioners did not cite, contains the answers to their erroneous contentions.

this Court recognized in *Western Fruit, supra*, 322 F.2d at 69, it is proper for the Commission to make its orders binding on all unnamed officers of a corporation, so the difference for which they argue is its application to them as individuals.

They do not specify as error or argue as unsupported by evidence the Commission findings (R. 136-39) that they are and have been the controlling owners of the corporation and the officers directly responsible for the practices found illegal, and that "the corporate [petitioner] is nothing but the 'alter ego' of those two individual [petitioners]." Instead they offer, as usual, assertions to the contrary (R. 95), citing their denials of power and responsibility, which the Commission did not believe and which are plainly incredible.

The decisions they cite do not support their contentions, when the real facts are taken into consideration, and they do not even attempt to support with citation of supposed authority their erroneous statement that "absent a showing of special circumstances indicating a likelihood that corporate petitioner may seek to evade the order issued, it was error for the Commission to include these individuals, as individuals, in the order" (Brief 95). The truth is that, as the Supreme Court held on similar circumstances in *Federal Trade Commission* v. *Standard Education Society*, 302 U.S. 112, 120 (1937), it would be error to delete them. The test is whether the Commission could reasonably have thought the prohibition is necessary. *Federal Trade Commission* v. *National Lead Co.*, 352 U.S. 419, 431 (1957). Clearly the Commission could have, and did, think so in this case.

CONCLUSION

For the foregoing reasons the Commission's order should be affirmed and enforced.[42]

Respectfully submitted.

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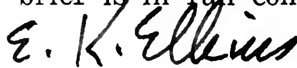
Washington, D. C.

March 1965

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.



E. K. ELKINS
Attorney for the Federal Trade Commission

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[42] "To the extent that the order of the Commission is affirmed, the court shall thereupon issue its own order commanding obedience to the terms of such order of the Commission." Federal Trade Commission Act, section 5(c), 52 Stat. 112, 15 U.S.C. 45(c). Section 11(c) of the Clayton Act, 73 Stat. 243, 15 U.S.C. 21(c), contains a similar provision.

APPENDICES

APPENDIX A

Federal Trade Commission Act, section 5(a)(1), 66 Stat 632; 15 U.S.C. 45 (a)(1):

> Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful.

Clayton Act, as amended, section 2, 49 Stat. 1526, 15 U.S.C. 13:

> (a) * * * it shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality * * * where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them: Provided that nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacturering, sale or delivery resulting from the differing methods or quantities in which such commodities are to such purchases sold or delivered * * *.
>
> (d) * * * it shall be unlawful for any person engaged in commerce to pay or contract for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale, or offering for sale of any products or commodities unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities.
>
> (f) * * * it shall be unlawful for any person engaged in commerce, in the course of such commerce,

knowingly to induce or receive a discrimination in price which is prohibited by this section.

Robinson-Patman Act, section 3, 49 Stat. 1528; 15 U.S.C. 13a:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, to be a party to, or assist in, any transaction of sale, or contract to sell, which discriminates to his knowledge against competitors of the purchaser, in that, any discount, rebate, allowance, or advertising service charge is granted to the purchaser over and above any discount, rebate, allowance or advertising service charge available at the time of such transaction to said competitors in respect of a sale of goods of like grade, quality and quantity * * *.

APPENDIX B

UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

COMMISSIONERS:

Paul Rand Dixon, Chairman
Sigurd Anderson
Philip Elman
Everette MacIntyre
A. Leon Higginbotham, Jr.

Docket No. 7492

In the Matter of

FRED MEYER, INC., a corporation, and
FRED G. MEYER and
EARLE A. CHILES, individually and as officers of said corporation.

FINAL ORDER

Pursuant to the Commission's order of March 29, 1963, respondents having filed objections to the proposed order to cease and desist in this proceeding, a proposed alternative order, and reasons in support thereof; and counsel in support of the complaint having filed a reply thereto; and

The Commission, for the reasons stated in the accompanying opinion, having rejected respondents' objections and having further determined that its proposed order to cease and desist should be issued as the final order of the Commission:

IT IS ORDERED that respondent Fred Meyer, Inc., a corporation, and its officers, and Fred G. Meyer and Earle A. Chiles, individually and as officers of corporate respondent, and respondents' agents, representatives and employees in connection with the offering to purchase or

purchase in commerce, as "commerce" is defined in the amended Clayton Act, of products for resale in outlets operated by respondents, do forthwith cease and desist from:

> Knowingly inducing, or knowingly receiving or accepting, any discrimination in the price of such products by directly or indirectly inducing, receiving or accepting from any seller a net price respondents know or should know is below the net price at which said products of like grade and quality are being sold by such seller to other customers where respondents are competing with the purchaser paying the higher price or with a customer of the purchaser paying the higher price.

For the purpose of determining the "net price" under the terms of this order, there shall be taken into account all discounts, rebates, allowances, deductions or other terms and conditions of sale by which net prices are effected.

IT IS FURTHER ORDERED that respondent Fred Meyer, Inc., a corporation, and its officers, and Fred G. Meyer and Earle A. Chiles, individually and as officers of corporate respondent, and respondents' agents, representatives and employees, directly or through any corporate or other device in or in connection with any purchase in commerce, as "commerce" is defined in the Federal Trade Commission Act, of products for resale in outlets operated by respondents, do forthwith cease and desist from:

> Inducing and receiving anything of any value from any supplier as compensation or in consideration for services or facilities furnished by or through respondents in connection with the processing, handling, sale or offering for sale of products purchased from such supplier, when respondents know or should know that such compensation or consideration is not being affirmatively offered or otherwise made available by such supplier on proportionally equal terms to all of

its other customers competing with respondents in the sale and distribution of such supplier's products, including other customers who resell to purchasers who compete with respondents in the resale of such supplier's products.

IT IS FURTHER ORDERED that respondent Fred Meyer, Inc., a corporation, and its officers, and Fred G. Meyer and Earle A. Chiles, individually and as officers of corporate respondent, shall, within sixty (60) days after service upon them of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with the order to cease and desist set forth herein.

By the Commission, Commissioner Elman dissenting and Commissioner Higginbotham not participating.

/s/ Joseph W. Shea
JOSEPH W. SHEA,
Secretary.

ISSUED: July 9, 1963

purchase in commerce, as "commerce" is defined in the amended Clayton Act, of products for resale in outlets operated by respondents, do forthwith cease and desist from:

> Knowingly inducing, or knowingly receiving or accepting, any discrimination in the price of such products by directly or indirectly inducing, receiving or accepting from any seller a net price respondents know or should know is below the net price at which said products of like grade and quality are being sold by such seller to other customers where respondents are competing with the purchaser paying the higher price or with a customer of the purchaser paying the higher price.

For the purpose of determining the "net price" under the terms of this order, there shall be taken into account all discounts, rebates, allowances, deductions or other terms and conditions of sale by which net prices are effected.

IT IS FURTHER ORDERED that respondent Fred Meyer, Inc., a corporation, and its officers, and Fred G. Meyer and Earle A. Chiles, individually and as officers of corporate respondent, and respondents' agents, representatives and employees, directly or through any corporate or other device in or in connection with any purchase in commerce, as "commerce" is defined in the Federal Trade Commission Act, of products for resale in outlets operated by respondents, do forthwith cease and desist from:

> Inducing and receiving anything of any value from any supplier as compensation or in consideration for services or facilities furnished by or through respondents in connection with the processing, handling, sale or offering for sale of products purchased from such supplier, when respondents know or should know that such compensation or consideration is not being affirmatively offered or otherwise made available by such supplier on proportionally equal terms to all of

its other customers competing with respondents in the sale and distribution of such supplier's products, including other customers who resell to purchasers who compete with respondents in the resale of such supplier's products.

IT IS FURTHER ORDERED that respondent Fred Meyer, Inc., a corporation, and its officers, and Fred G. Meyer and Earle A. Chiles, individually and as officers of corporate respondent, shall, within sixty (60) days after service upon them of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with the order to cease and desist set forth herein.

By the Commission, Commissioner Elman dissenting and Commissioner Higginbotham not participating.

/s/ Joseph W. Shea
JOSEPH W. SHEA,
Secretary.

ISSUED: July 9, 1963

APPENDIX C

UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

COMMISSIONERS:

Paul Rand Dixon, Chairman
Philip Elman
Everette MacIntyre
John R. Reilly

Docket No. 7494

In the Matter of

CANNON MILLS COMPANY,
a corporation.

Order Vacating Initial Decision and
Dismissing Complaint

This case is before the Commission on the appeal of complaint counsel from the initial decision of the hearing examiner, filed December 3, 1963. While finding a *prima facie* violation by respondent of Section 2(a) of the Clayton Act, as amended, the examiner dismissed the complaint on the ground that respondent had succeeded in its cost-justification defense. Upon examination of the record, the Commission has concluded that the evidence of record is insufficient to prove the requisite adverse effects on competition. Since a *prima facie* violation was not proved, it is unnecessary to reach the merits of respondent's cost-justification defense. Accordingly,

IT IS ORDERED that the initial decision of the examiner be, and it hereby is, vacated.

IT IS FURTHER ORDERED that the complaint be, and it hereby is, dismissed for failure of proof on the issue of probable injury to competition.

By the Commission.

SEAL

/s/ Joseph W. Shea
JOSEPH W. SHEA
Secretary.

ISSUED: April 24, 1964

☆ U. S. GOVERNMENT PRINTING OFFICE; 1965 766166 654

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 18,903

FRED MEYER, INC., a corporation, and FRED G. MEYER and EARLE A. CHILES, individually and as officers of said corporation, *Petitioners,*

v.

FEDERAL TRADE COMMISSION, *Respondent.*

On Petition to Review and Set Aside Order of the Federal Trade Commission

REPLY BRIEF FOR PETITIONERS

FILED

APR 13 1965

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 18,903

FRED MEYER, INC., a corporation, and FRED G. MEYER and EARLE A. CHILES, individually and as officers of said corporation, *Petitioners,*

v.

FEDERAL TRADE COMMISSION, *Respondent.*

On Petition to Review and Set Aside Order of the Federal Trade Commission

---

REPLY BRIEF FOR PETITIONERS

I. Respondent's Contention That "Much" of Petitioners' Argument Is Vitiated By Failure to Specify as Erroneous the Challenged "Findings" of the Commission Is Without Merit

Respondent argues that "much" of petitioners' argument is vitiated by their reliance upon facts contrary to so-called "findings" not specified as error and asserts that petitioners seek a trial *de novo* by this Court (Resp. Br., pp. 31-35). Such contentions are unfounded. Respondent itself points out that petitioners argue the evidence does not support the conclusions and inferences of the Commis-

sion, that the Commission erred as a matter of fact and law in finding the alleged violations and that the Commission's decision and order should be set aside (*E.g.,* Resp. Br., pp. 40, 70, 67-73, 77). This, of course, questions the validity of all the ultimate findings of the Commission and, as respondent also notes (Resp. Br., p. 3, n. 3), petitioners challenge each of these conclusions directly as not being "supported by reliable, substantial and probative evidence as required by the Administrative Procedure Act," citing the landmark decision of *Universal Camera Corp.* v. *NLRB,* 340 U.S. 474 (1951) (Pet. Br., p. 7). Petitioners also so specify in their petition to review (R. 707-14).

Thus, while admitting that the ultimate conclusory findings of the Commission are in issue, respondent apparently contends that the specification of errors should have contained a specific challenge to each subsidiary "finding." This is tantamount to arguing that a finding by the Commission of a violation of law is not reviewable and is, indeed, an outright attempt to avoid judicial review. The Commission's decision consists of 63 pages of mixed findings, arguments, inferences, policy declarations, etc. Many of the so-called "findings" of fact as to the "evidence" are not findings at all but consist of inferential conclusions and arguments. Indeed, there are no findings of fact actually so denominated. Respondent now, by relying to a substantial degree upon the so-called "findings" as if they were evidence is openly inviting the Court to "rubber stamp" its ultimate holding without the exercise of any review function.

As stated in *Universal Camera, supra,* "it cannot be too often repeated that judges are not automata" in the exercise of their function in reviewing acts of administrative agencies (340 U.S. at 489). The Courts, of course, have a duty under the Administrative Procedure Act to "review the whole record or such portions thereof as may be cited . . ." (5 U.S.C. § 1009(e)). The meaning of this requirement was made clear by the *Universal Camera* holding that a court must set "aside a Board decision when it cannot conscientiously find that the evidence supporting that deci-

sion is substantial, when viewed in the light that the record in its entirety furnishes, including the body of evidence opposed to the Board's view'' (340 U.S. at 488).

The adverse conclusory findings and rulings of the Commission are the very basis of petitioners' appeal here, and each has been directly and properly challenged.

II. The Commission Cannot Claim Jurisdiction Under Section 5 of the Federal Trade Commission Act to Proceed Against a Buyer for the Inducement and Receipt of Promotional Allowances

Respondent argues that ''Congress' omission to mention the practice [of inducing discriminatory promotional allowances] when amending Section 2 of the Clayton Act was inadvertent rather than studious. . .'' (Resp. Br., p. 37) and, on this basis, claims jurisdiction under Section 5 of the Federal Trade Commission Act. The assertion of ''inadvertent'' omission is overwhelmingly contradicted by the legislative history of the Robinson-Patman Act which conclusively establishes that Congress deliberately and with conscious intent omitted the inducement of discriminatory promotional allowances from the coverage of that Act. The unrebuttable facts are:[1]

1. The Federal Trade Commission Act and the Clayton Act were passed by the same Congress in 1914. Pub. L. No. 203, 63d Cong., ch. 311, §§ 1-11, 38 Stat. 717-724 (Sept. 26, 1914); Pub. L. No. 212, 63d Cong., ch. 323, §§ 1-26, 38 Stat. 730-740 (Oct. 14, 1914).

2. While the House and Senate were deliberating upon the Federal Trade Commission Act in 1914, the Senate adopted a floor amendment to the Clayton Act striking out the section relating to price discrimination upon the theory that this subject matter was covered by the phrase ''unfair. methods of competition'' in the Federal Trade Commission Act and that this matter would, therefore, be dealt with under that Act (51 Cong. Rec. 13849, 15828, 16154; Appendix, pp. 1-3, 12).

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[1] For the convenience of the Court, the pertinent legislative materials referred to in this section are reproduced in the Appendix to this brief.

3. The Conference Committee reinstated the price discrimination prohibitions in the Clayton Act (Section 2) and authorized the Federal Trade Commission to issue restraining orders *under that Act* to prevent such discriminations because such discriminations were not covered by the Federal Trade Commission Act (51 Cong. Rec. 15828, 16154, 16317-16318; Appendix, pp. 1-3, 13; S. Doc. No. 585, 63d Cong., 2d Sess. on H.R. 15657, 51 Cong. Rec. 16264), and then enacted the Clayton Act on October 15, 1914, after the Federal Trade Commission Act had been passed on September 26, 1914.

4. In its *Final Report on the Chain-Store Investigation,* S. Doc. No. 4, 74th Cong., 1st Sess. (1934), at 96-97, the Commission, prior to the Robinson-Patman Act amendments to the Clayton Act in 1936, recommended amendment of Section 2 of the Clayton Act to include a broad general prohibition against price discriminations (Appendix, p. 3). This amendment was, of course, unnecessary if the Commission had jurisdiction under Section 5 of the Federal Trade Commission Act to prohibit such discriminations.

5. In the same report, the Commission explained that its recommendation for a broad, generalized amendment outlawing discriminations would be a "simple solution for the uncertainties and difficulties of enforcement [and] would be to prohibit unfair and unjust discrimination in price and leave it to the enforcement agency, subject to review by the courts, to apply that principle to particular cases and situations. . ." (*Final Report on the Chain-Store Investigation, supra* at 96). Congress refused to grant this broad authority and enacted instead very precise legislation in the Robinson-Patman amendment.

6. In the First Session of the 74th Congress in 1935, Representative Mapes introduced the exact bill recommended by the Commission in an attempt to obtain Congressional approval of "unfair or unjust" discrimination as the legal standard. The Mapes bill was rejected because Congress did not wish to leave it up to the administrative

agency to determine the standards for enforcement (*Final Report on the Chain-Store Investigation, supra,* at 96-97; H.R. 4995, 74th Cong., 1st Sess. (Jan. 29, 1935); 80 Cong. Rec. 8103-8104; *Hearings Before the House Committee on the Judiciary,* 74th Cong., 1st Sess., ser. 10, pt. 1, at 254-255 (1935) (from "Brief Submitted by H. B. Teegarden"); Appendix, pp. 3-7). Since Congress specifically rejected the standard of "unfair" in the Mapes bill in 1935, the Commission cannot resort to the same "unfair" standard enacted in 1914 in Section 5 and apply it to discriminatory practices.

7. In its *Chain-Store* report, the Commission further pointed out that new legislation outlawing discriminations in price was necessary because: "The point cannot be overlooked that if price discrimination was included under the general prohibition of unfair methods of competition when the Federal Trade Commission Act was passed, the latter expression of legislative will in the Clayton Act dealt specifically and in detail with the subject and would therefore seem to take precedence over the more general statutory prohibition" (*Final Report on the Chain-Store Investigation, supra,* at 65; Appendix, p. 7). This is hornbook law. 2 Sutherland, *Statutory Construction* § 5204 (3d ed. 1943). *A fortiorari,* the same principle applies to the Robinson-Patman Act amendment enacted in 1936, 22 years after passage of the Federal Trade Commission Act.

8. Permeating the legislative history of the Robinson-Patman Act is the often repeated declaration that Congress was dealing with concessions exacted by large *buyers* from sellers. 80 Cong. Rec. 6335, 5726-5727, 6257; *Final Report on the Chain-Store Investigation, supra,* at 49 (1934); *Hearings Before the House Committee on the Judiciary,* 74th Cong., 1st Sess., ser. 10, pt. 1, at 31-32 (1935) (from "H.R. 8422, A Bill to Amend Section 2 of the Clayton Act," Specific Questions Answered by H. B. Teegarden); Appendix, pp. 7-9.

9. The Robinson-Patman Act was conceived, as demonstrated by Congressional deliberations, to cure abuses of

buying power by means of sanctions against *sellers* rather than buyers as this approach was considered to be more effective. 80 Cong. Rec. 8227; *Hearings Before the House Committee on the Judiciary, supra,* at 31-32; *Final Report on the Chain-Store Investigation, supra,* at 49 (1934); Appendix, pp. 8-9; Rowe, *Price Discrimination Under the Robinson-Patman Act,* 12 et seq. (1962).

10. Omission of buyer liability in the Robinson-Patman Act could not have been inadvertent since Congress, in specific reference to Section 2(d) providing for action only against sellers, clearly recognized that the prohibited practice resulted from buyer initiation and inducement. H.R. 2287, 74th Cong., 2d Sess., at 15-16 (1936); 80 Cong. Rec. 6257; Appendix, p. 10. Indeed, the Act was known as anti-chain store legislation. Rowe, *op. cit. supra,* at 3-5, 8-11.

11. In the light of constant Congressional awareness when considering the legislation that discriminatory promotional allowances were invariably a result of buyer inducement, it cannot be said that the omission from the Act of buyer liability was inadvertent.

12. If there was any "inadvertence" by Congress (which there clearly was not) logic would dictate that, should any strained statutory construction be indulged in, it must be to construe Section 2(f) of the Robinson-Patman Act to include promotional allowance inducements since it was the universal conception of both Houses of Congress that promotional allowances were merely a variation or species of price discrimination. 80 Cong. Rec. 8110, 8127, 8128, 8236 and 9419; *Hearings Before the House Committee on the Judiciary,* 74th Cong., 1st Sess., ser. 10, pt. 1, at 31 and 218 (1935); *Final Report on the Chain-Store Investigation, supra,* at 59-60; Appendix, pp. 10-12; Rowe, *op. cit. supra,* at 432-436.

13. In *Automatic Canteen Co.* v. *FTC,* 346 U.S. 61 (1953), the Supreme Court pointed out that "the Commission has, by virtue of the Robinson-Patman Act, been given some authority to develop policies *in conflict with those of the*

Sherman Act in order to meet *the special problems created by price discrimination*" and that, therefore, "although due consideration is to be accorded to administrative construction where alternate interpretation is fairly open, it is our duty to reconcile such interpretation, *except where Congress has told us not to,* with the broader antitrust policies that have been laid down by Congress" (*Id.* at 74; emphasis added). Expansion of jurisdiction to cover buyer inducement of promotional allowances under Section 5 on the ground Congress "inadvertently" omitted it in the Robinson-Patman Act is contrary to the *Automatic Canteen* injunction for strict construction of the Robinson-Patman Act to minimize conflict with the Sherman Act.[2]

III. The Payments Received in Connection With the Coupon Promotions Are Not Cognizable Under Section 2(a)

In attempting to answer petitioners' first threshold argument, *i.e.,* that the payments here involved are cognizable, if at all, only under Section 2(d) (Pet. Br., pp. 16-26), respondent states that Sections 2(a) and 2(d) "are not mutually exclusive" and that even if the payments received by petitioners "were for services rendered by petitioners" this would not preclude them from also constituting price discriminations, since payments for services and facilities "may or may not amount to indirect price discriminations within the meaning of Section 2(a)", quoting from Austin, *Price Discrimination and Related Problems Under The Robinson-Patman Act* (Resp. Br., p. 78). The quoted statement appears in Austin's pamphlet without supporting authorities and refers to "indirect price discriminations." It is obvious that if a payment for services or facilities is merely a subterfuge for a price discrimination, as a matter of fact, it can amount to indirect price discrimination. But that, of course, is not the fact in the instant case. The only other authorities referred to by respondent are two "*Cf.*" references which are completely meaningless, *viz., Elizabeth Arden Sales Corp.* v. *Gus Blass Co.,* 150 F. 2d 988 (8th Cir.

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2 See also, Report of the Attorney General's Committee to Study the Antitrust Laws (1955), pp. 148-149, n. 78.

1945), and *Sun Cosmetics Shoppe* v. *Elizabeth Arden Sales Corp.,* 82 F. Supp. 687 (S.D.N.Y. 1949). Both of these cases deal with the interrelationship between Sections 2(d) and 2(e) and bear no relationship whatsoever to price discriminations under Section 2(a). In the absence of decisional authority, respondent urges that "overlapping coverage [*i.e.,* making the same transaction actionable indiscriminately under Sections 2(a) or 2(d)] is consistent with the Congressional purpose" (Resp. Br., p. 78) to outlaw discriminatory rebates. The point is, however, that Congress delineated specific and differing statutory criteria for different types of discriminations. Thus, Section 2(a) prohibits price discriminations only where it is shown that the effect may be to substantially lessen competition, whereas, under Section 2(d), injury to competition is presumed. Moreover, a showing of discrimination and probable competitive injury constitutes proof only of a *prima facie* Section 2(a) case which may be rebutted and against which certain affirmative defenses may be advanced, such as cost justification and changing market conditions. On the other hand, Section 2(d) is a *per se* section under which such exculpatory defenses are not available. Congress having delineated the required substantive proofs and procedures as to burden of proof with respect to the separate sections, it is completely illogical to assume that it made the same transaction subject to a *per se* rule, as in Section 2(d), and at the same time subject to a non-*per se* rule, with multiple affirmative defenses available, as in Section 2(a). Significantly, petitioners here do not claim that the transactions fall under that section which enlarges the burden of proof of respondent or bestows upon petitioners exculpatory defenses—it is petitioners' contention that the transaction falls under Section 2(d), the *per se* section.

Petitioners, in their main brief, suggested that the Commission's categorization of the payments received by Fred Meyer as being subject to both 2(a) and 2(d) was arbitrary, pointing out that companion cases against petitioners' suppliers were inconsistent. In its reply brief, respondent takes issue only with our treatment of one of

these cases, *Tri-Valley,* asserting that two complaints, one under Section 2(a) and one under Section 2(d), were issued and consolidated for hearing; that, while the complaint in the 2(d) case admittedly alleged both the $350 payment for printing and distributing the coupon book and the additional payment for redemption of the promotional coupons as violative of Section 2(d), the hearing examiner found only that the $350 payment violated 2(d); and that, consequently, there was no issue before this Court on review of the Commission's *Tri-Valley* decision as to whether the *total* payment by *Tri-Valley,* to petitioners was cognizable under Section 2(d) (Resp. Br., p. 79-80). This is completely erroneous. While it is true that the examiner's finding in the *Tri-Valley,* case concerned only the $350 payment in connection with the alleged 2(d) violation (60 F.T.C. 1134, 1146-47), the full Commission "vacated and set aside" the examiner's initial decision for failure "to make adequate findings of fact" and entered its own "findings, conclusions and order. . ." (60 F.T.C. at 1175).

In its own findings of fact, the Commission found that Tri-Valley granted promotional allowances to Fred Meyer and that "the arrangement to grant the allowance was a specially tailored or negotiated deal involving promotional activities initiated by the purchaser" (60 F.T.C. at 1182). The Commisison made no reference to the limited $350 payment, as had the hearing examiner, and specifically found that Tri-Valley "granted allowances for merchandising services furnished by such retailers [including Fred Meyer] in the resale of these private label goods" (*Id.* at 1174).

On review of the case, respondent Commission set forth in its brief to this Court (pp. 20-21) the facts relevant to the Tri-Valley transaction and expressly noted that Tri-Valley's payment included both the $350 amount and the amount granted for redemption of coupons. The Commission then stated Tri-Valley's argument that the transaction was not cognizable under 2(d) as follows:

Petitioner contends (brief p. 158) that the evidence:

> * * * shows clearly that Petitioner agreed to make these payments [*viz.,* the special promotional pay-

> ments to two of its customers] to induce and facilitate the *original* sales, and that the purchasers did not agree to contract to render any services or to furnish any facilities in connection with the *subsequent resale* of the goods.[3]

In answering petitioner Tri-Valley's contention, the Commission stated at page 60 of its brief to this Court:

> In 1957, petitioner participated in the Meyer "coupon book" program. Specifically, petitioner paid Meyer the flat sum of $350.00 to cover the cost of an advertisement in the Meyer "coupon book"; *as part of this same advertising promotion, petitioner also contracted to redeem the coupons returned to it by Meyer* (emphasis added).

With the issue thus posed four-square, this Court, in its *Tri-Valley* decision, restated the facts, noting specifically that the coupon redemption amount was an integral part of the agreement (329 F. 2d at 707) and then agreed with the Commission and held squarely that the *total* transaction was cognizable under Section 2(d). In view of this, it is clearly incorrect factually, and respondent is estopped from now arguing as it does, that in the *Tri-Valley* case only the $350 payment was in issue (Resp. Br., p. 80). The only unanswered question, therefore, is whether the identical transaction can *also* be cognizable under Section 2(a). As we have pointed out, respondent has advanced no authority, case law or otherwise, in support of its novel proposition. On the other hand, petitioners' authorities (Pet. Br., pp. 16-26) demonstrate conclusively that the payments made in connection with Fred Meyer's coupon promotion are cognizable, if at all, only under Section 2(d).

Petitioners also argued that the Commission erred as a matter of *fact* in its holding that the total payment was not in consideration of services and facilities rendered (Pet. Br., p. 7). Respondent declines to even come to grips (Resp. Br., p. 80, n. 32) with petitioners' conclusive factual showing in this respect (Pet. Br., pp. 20-23).

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[3] Petitioner Tri-Valley argued at page 158 of its brief: "When the facts are as hereinabove summarized, the payments or allowances do not fall within the prohibitions of subsection (d)."

IV. Wholesale Customers Are Not Entitled to Promotional Benefits Equivalent to Those Granted Retail Customers Under Section 2(d)

In their second threshold argument, petitioners urge that Section 2(d) does not require a seller who offers or grants promotional allowances to retail customers to offer proportional allowances to its wholesale customers. Respondent admits that its holding in this case is diametrically contrary to prior Commission precedent; that its position "is at odds with this Court's ruling in *Tri-Valley Packing Association* v. *Federal Trade Commission";* and that this Court's ruling in *Tri-Valley* "of course, is now the law of the *Tri-Valley* case" (Resp. Br., p. 58). Nonetheless, respondent asks the Court to apply a different rule of law here than that applied in *Tri-Valley.* The net result is paradoxical: As to Tri-Valley the transaction at issue is completely legal but as to Fred Meyer the same transaction is illegal. A mere statement of the proposition requires its rejection.

Lacking any authority for its holding, except one District Court case, which petitioners contend is not in point (Pet. Br., pp. 34-35), respondent resorts to the bald assertions that its former construction of the statute, which it has administered for over 25 years (since 1936), is in "conflict with economic reality" (Resp. Br., p. 61), is "contrary to the plain language" of the statute, produces an "inequitable result" and is contrary to legislative intendment (Resp. Br., p. 59). Under such circumstances, we submit, these assertions cannot be taken seriously.[4]

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[4] Answering a similar contention of the Commission, the Supreme Court stated in *FTC* v. *Bunte Brothers,* 312 U.S. 349 (1941):

> That for a quarter century the Commission has made no such claim is a powerful indication that effective enforcement of the Trade Commission Act is not dependent on control over intrastate transactions. Authority actually granted by Congress of course cannot evaporate through lack of administrative exercise. But just as established practice may shed light on the extent of power conveyed by general statutory language, so *the want of assertion of power by those who presumably would be alert to exercise it, is equally significant in determining whether such power was actually conferred* (*Id.* at 351-52; footnote omitted; emphasis added).

Moreover, if we are to depart from the clear language of the statute and 25 years of consistent construction, "eco-onmic reality" and "equity" support petitioners. While a retailer, such as Fred Meyer, can contract to furnish, and can actually furnish, value to the seller in return for a promotional allowance, a wholesaler cannot normally do so. He sells to wholly independent retailers. Thus, if the seller grants the wholesaler a per case promotional allowance, the wholesaler may pocket the allowance, pass it on to his favored customers, or give it to all of his retail customers. But the wholesaler is not set up to assure the seller it has received its proper *quid pro quo* in promotional and advertising efforts.[5] Obviously, it would be unfair to require the seller to pay such allowances where the recipient, by virtue of the very nature of its operation, cannot assure receipt of value in return. To avoid this result and attempt to obtain his *quid pro quo,* the seller would have to police the pricing and promotional allowance policies of his wholesale customers. Even if permitted, this would involve so much detailed investigation by the seller that it would not be worth the candle and would raise a serious question as to the seller's liability under the Sherman Act for interference with his wholesale customers' pricing and promotional policies.

Respondent, attempting to avoid petitioners' well-founded contention that the theory of the complaint in this case is so at variance with the rationale of the decision that no order can be properly entered, characterizes it as frivolous, merely states that petitioners had the opportunity to develop all the relevant facts, and asserts that

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[5] The Wadhams witness, for example, testified that his company "would not have been interested in an advertising allowance as such, for our Wadham's brand" since it would demand "that we perform a function of advertising, which requires an expenditure of money" and "none of our stores would have been interested in advertising the Wadham's grade of corn" (R. 272-73). Not only does this emphasize petitioners' position, but it precludes a finding of a Section 2(d) violation by Idaho Canning with respect to Wadhams since a supplier is not required to engage in a futile gesture, *i.e.,* offer promotional benefits when such offer would be rejected. *Vanity Fair Paper Mills, Inc.* v. *FTC,* 311 F. 2d 480, 485 (2d Cir. 1962); *Liggett & Myers Tobacco Co., Inc.,* 56 F.T.C. 221, 253 (1959).

the only issue is the proper application of the law to such facts (Resp. Br., p. 66, n. 26).[6] But the development of so-called "relevant facts" presupposes a knowledge of the status of the law at the time of trial to which such facts are relevant. Here the law was clear at the time of trial—wholesalers were not legally entitled to allowances proportional to those accorded retailers. Thus, there was no occasion to adduce evidence as to whether sellers generally accord to wholesalers different terms and conditions of purchase, or offer to them different types of promotional aids in view of their radically different structural make-up as compared to retailers; whether sellers service wholesalers in a different manner to the benefit of the wholesaler; whether wholesalers even want promotional allowances for which they must prove the actual rendering of services and facilities; and a host of other factual considerations bearing on so-called "economic reality" and fairness.

All petitioners were required to prove under existing law at the time of the trial was that the alleged disfavored customers of its suppliers were wholesalers and the matter was at an end. *Atalanta Trading Corp.*, 53 F.T.C. 565 (1956), *set aside on other grounds*, 258 F. 2d 365 (2d Cir. 1958); *Liggett & Myers Tobacco Co., Inc.*, 56 F.T.C. 221 (1959).

In the instant case, the Commission directly overruled its *Liggett & Myers'* holding (R. 93). Petitioners do not question the Commission's right to do so; but to retroactively apply the reversal of long-standing precedent and base findings of illegality on transactions admittedly legal at the time they were entered into is quite another matter and, in equity and fairness, abhorrent to the law. The Supreme Court recently, in *Simpson* v. *Union Oil Co.*, 377 U.S. 13

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[6] In its "Opinion On Respondents' Exception To The Proposed Order," the Commisison states that "each and every one of the *facts*" on which it based its conclusion was "put in issue by the pleadings" and was "vigorously litigated" (R. 148). In support of this holding, the Commission, however, specifically acknowledges that the "question of fact was thoroughly litigated under the *pricing count* of the complaint" (R. 152; emphasis added) and its entire discussion answering petitioners' argument relates to the evidence and facts under the Section 2(a) count (see R. 152-55).

(1964), reexamined an earlier decision, *United States* v. *General Electric Co.,* 272 U.S. 476 (1926), in which it had been held lawful for sellers to use agents and set their resale prices and, in effect, overruled it. However, in recognition of the fact that Union Oil's contracts were legal under *General Electric* when put into effect, the Court stated: "We reserve the question whether, when all the facts are known, there may be any equities that would warrant only prospective application in damage suits of the rule governing price fixing by the 'consignment' device which we announce today" (377 U.S. at 24-25). Subsequently, the District Court in *Lyons* v. *Westinghouse Electric Corp.,* 1964 Trade Cas. ¶71,266 (S.D. N.Y. 1964), refused to apply retroactively the law enunciated in *Simpson* because it would be "manifestly unjust" to do so, stating: "the Supreme Court may eventually decide that it will not apply the new doctrine to the Union Oil Company in that particular case, but will limit itself to announcing that the new rule will henceforth govern future cases" (*Id.* at p. 80, 153).

The unfairness of retroactive application by agencies such as respondent Commission is accentuated by the liberality in their rules of evidence, by the combination of prosecution and adjudicative functions, and by the utilization of tenuous inferences upon which to base convictions. In *NLRB* v. *International Brotherhood of Teamsters,* 225 F. 2d 343 (8th Cir. 1955), the Board, in finding the Union guilty of an unfair labor practice, had expressly overruled one of its earlier decisions. The Court held that the Board may put potential parties on notice by a general statement of policy in advance and, in so doing, notify those subject to its jurisdiction of the abandonment of contrary prior precedent in future actions or overrule or abandon prior views and holdings. But, said the Court, "we do not believe that the spirit of the Act, either administrative or general, entitles the Board, on engaging in such an about-face from its previous position and ruling, no matter in what manner or circumstances this is done, to brand a party as being guilty of an unfair labor practice" so long as the

"Board's express [prior] holding . . . has remained unrenounced" (*Id.* at 348). These simple principles of fairness have been applied in many administrative proceedings.[7]

V. The Alleged Section 2(f) Violation

A. The Commission Erred In Finding That Requisite Adverse Competitive Effects Were Shown

Respondent attempts to brush aside petitioners' argument that the Commission erred in finding that requisite adverse competitive effects resulted from the price discriminations received by Fred Meyer by erroneously asserting that *American Oil Co.* v. *FTC,* 325 F. 2d 101 (7th Cir. 1963), *cert. denied,* 377 U.S. 954 (1964), is inapposite.

To the contrary, the legal principles governing the application of Section 2(a) to *temporary* differences in price, such as those here concerned, were specifically enunciated in *American Oil.* There, as here, the Commission had applied rigidly the *Morton Salt*[8] holding, which related to permanent price reductions installed pursuant to a corporate policy designed to favor large buyers, and found a violation on the theory that illegal price discriminations can be inferred from any substantial price difference, no matter how short its duration and notwithstanding the absence of discernible competitive effects. But this theory the Court expressly rejected, holding there is a vast difference between temporary and permanent price differences:

> The record here does not present that inherent capability of lessening competitive ability as was evidenced by the discriminatory pricing system in F.T.C. v.

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[7] See *Lesavoy Foundation* v. *Commissioner of Internal Revenue,* 238 F. 2d 589 (3d Cir. 1956), *Wood Wire and Metal Lathers International Union,* 119 N.L.R.B. 166 (1958), 7 Ad. L. (2d Series) 781, *Franco Western Oil Co.,* 65 I.D. 427 (1958), 8 Ad. L. (2d Series) 749.

Indeed, the Federal Trade Commission in earlier days recognized the equities under such circumstances when, in *Arnold Constable Corp.,* 55 F.T.C. 577 (1958), it dismissed a complaint even though a violation of law had been proved since the respondent there had relied upon informal advice of certain Federal Trade Commission personnel. Certainly, a well considered precedent of many years standing decided by the full Commission in its quasi-judicial capacity is of even greater stature.

[8] *FTC* v. *Morton Salt Company,* 334 U.S. 37 (1948).

> Morton Salt Co. . . ., which gave buyers of large quantities a built-in, routine and permanent price advantage over smaller rivals (325 F. 2d at 106).[9]

The ultimate factual question, the Court ruled, is whether "the price discrimination creates a reasonable probability of substantial injury to competition—such an injury as will with reasonable probability substantially lessen the ability of the unfavored dealers to continue to compete (325 F. 2d at 104). Discrimination, held the Court, "*no matter if substantial,* must in the particular factual situation involved be capable" of creating such adverse, competitive effects (*Ibid*; emphasis added). And this test is not satisfied by proof of a "minor and temporary loss of business," "an essentially temporary minimal impact on competition," or even by an "actual economic loss" which is only "slight" (325 F. 2d at 104, 105, 106).

Despite all this, respondent argues that the Court in *American Oil* "explicitly distinguished" the situation there and that here (Resp. Br., p. 82). However, the distinctions made by the Court (325 F. 2d at 106) were between precisely the situation here, *i.e.,* where temporary price differences are involved, and that in which the price differences are "routine and permanent," as in *Morton Salt, supra,* are "systematic" as in *Corn Products Refining Co.* v. *FTC,* 324 U.S. 726 (1945), or are "continuing" and "systematic" as in *E. Edelmann & Co.* v. *FTC,* 239 F. 2d 152 (7th Cir. 1956), *cert. denied,* 355 U.S. 941 (1958).

Moreover, the Commission itself found that the concessions received by petitioners during the four-week promotion were not such as to create a reasonable possibility of substantial injury to competition when it dismissed the charge that Cannon Mills violated Section 2(a) in granting the very allowances here in issue on the express ground that there was no basis for a finding of competitive injury (Pet. Br., p. 79).

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9 American Oil's price differences continued for approximately three weeks (325 F. 2d at 103); Fred Meyer's continued for four weeks (R. 62). American Oil's "favored" customers received price reductions ranging from 20% to nearly 50% (60 F.T.C. at 1792, n. 2). Here the reductions were even less.

B. The Commission Erred In Finding That Petitioners Knew Or Had Reason To Know That The Prices Received Were Unlawful

As to one of the elements which respondent had the burden of proving, *i.e.,* that petitioners knew or had reason to know that the allowances received were not cost justified, respondent admits, as it must, that the Commission's so-called "finding" to this effect is an inferred finding based upon other inferred findings (Resp. Br., p. 86). Respondent's first argument that the Commission's "inferred finding" that Fred Meyer pays, "during eleven months out of the year, the same price that every other buyer pays," and "after the one-month period of the coupon book promotion ends, they go back to paying that higher price" (Resp. Br., p. 86) is irrelevant, even if, as respondent erroneously contends, there were direct evidence of such. It is the large volume purchases during the coupon promotion, the one-month period, which justify the lower prices received and these quantities were purchased only during that period. Respondent disregards this fact and, indeed, admits that the Commission merely *"drew an inference* that petitioners' purchasing in *larger quantites* than their competitors does not generate 'any measurable cost savings for those sellers' " (Resp. Br., p. 86; emphasis added).

As respondent acknowledges, the Supreme Court held in *Automatic Canteen* that "a buyer who knows that he buys in the same quantities as his competitor and is served by the seller in the same manner or with the same amount of exertion as the other buyer can fairly be charged with notice that a substantial price differential cannot be justified" but that when methods or quantities differ the Commission must show the differences "could not give rise to sufficient savings in cost . . . to justify the price differential" (346 U.S. at 80). The evidence here conclusively shows that the quantities purchased by petitioners and by the allegedly disfavored competitors were substantially different (Pet. Br., pp. 70-72). It was, therefore, as the Supreme Court held in *Automatic Canteen,* the Commission's burden to "show" (not to infer) that the differences in quantities or methods did not give rise to sufficient sav-

ings in cost to justify the price differences, or to "show" (not to infer) that the actual cost savings were "very small compared with the price differential." Having failed to meet this burden, respondent now argues that the admittedly and substantially greater quantities purchased by Fred Meyer have no bearing upon the inferences which can be drawn (Resp. Br., pp. 87-88).[10] Indeed, it argues that *Automatic Canteen* "plainly did not . . . hold" that an inference of guility knowledge is improper under such circumstances (Resp. Br., pp. 87-88). Once the discrepancy in size of purchases was shown, however, as this Court held in its *Alhambra* decision,[11] the *Automatic Canteen* holding clearly requires the Commission to show that cost savings did not justify the price differential. The inferences of the Commission do not satisfy that burden.

Respondent, believing that "in equity petitioners should have the benefit" of the Commission's determination in the *Cannon Mills* case, has abandoned its contention and finding that Cannon Mills violated Section 2(a) here (Resp. Br., pp. 74-75). While the Commission in this case has held that petitioners had "every reason to believe that there is not the *remotest* possibility of 'cost justification'" and "accordingly, [saw] no necessity for a prolonged inquiry as to whether or not [petitioners] volume of purchases . . . *did in fact* effect cost savings" (R. 135-36; emphasis added), such an inquiry in the *Cannon Mills* case proved conclusively that the price difference was more than cost justified (see Pet. Br., pp. 76-77). The Commission's improper *inference* that prices received by Fred Meyer were not cost justified epitomizes the impropriety of its specula-

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10 Despite the specific evidence showing purchases of substantially different quantities, respondent makes the specious assertion, referring to testimony of the Idaho Canning witness, that "petitioners and Hudson House purchased substantially the same quantities of its products (R. 497)" (Resp. Br., p. 88). This witness, however, was testifying, without benefit of documents, as to the *general* volume of purchases, acknowledged that petitioners' purchases of "fancy canned corn" were larger than Hudson Houses', and, more importantly, was not referring at all to Fred Meyer's purchase in connection with its promotion (see R. 497).

11 *Alhambra Motor Parts* v. *FTC,* 309 F. 2d 213, 219 (9th Cir. 1962).

tive, argumentative "findings," requires that they be set aside, and testifies eloquently to the validity of the Supreme Court's holding that lack of cost justification can be found only after specific inquiry into all relevant facts.

Respondent next argues, as it does with regard to the alleged Section 5 violation, that the mere initiation by a buyer of a price concession is sufficient to place upon it a duty of affirmative inquiry as to legality and, in effect, that such initiation permits automatically a finding of "guilty knowledge" (Resp. Br., pp. 88-89). This, of course, is diametrically opposed to the Supreme Court's *Automatic Canteen* holding (see pp. 26-29, *infra*).[12]

Additionally, respondent argues that "petitioners' *contract* with [the participating] suppliers provided that the arrangement under which those suppliers' products were

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[12] Respondent also argues that petitioners exercised "coercive pressures" upon Idaho Canning to obtain that supplier's participation in the 1957 promotion (Resp. Br., pp. 82-83, n. 34), stating:

> . . . petitioners approached that supplier about the matter early in 1957, . . . Idaho did not agree to grant the discriminations and did or said nothing to lead petitioners to believe that it had agreed, but petitioners nevertheless featured an Idaho Canning product in their 1957 sale and thereafter billed it $350 for the coupon-book page and $2,953.41 for the ⅓ cut in price. It [the Commission] found that Idaho denied the debt and returned the bill to petitioners, and thereafter petitioners deducted the total from a payment to Idaho, that Idaho protested and petitioners returned the money to Idaho, but a few months later Idaho yielded and shipped to petitioners $2,935.41 worth of free goods (Resp. Br., p. 83).

The fatal flaw in this contention is the implication that petitioners, absent an agreement and without authority, featured an Idaho Canning product in the promotion and then "coerced" payment therefor. The evidence, however, is that petitioners actually believed, in good faith, that Idaho Canning had agreed to participate and was so advised by Idaho Canning's broker (R. 207-09). Indeed, a specific arrangement was negotiated, believed agreed upon, and submitted in writing to Fred Meyer's coupon book committee (R. 208-09; CX 38). On the basis of this belief, Fred Meyer included Idaho Canning in the promotion. After the promotion was completed it apparently developed that Idaho Canning's broker had exceeded his authority in committing Idaho's participation. Since Fred Meyer is charged with having induced Idaho Canning's *participation* with knowledge that the allowances received would be unlawful, respondent's argument that the circumstances referred to rendered the claimed lack of knowledge culpable is without merit.

sold at greatly reduced prices to petitioners for resale during the coupon-book sale, would be exclusive during the 4-week period,'' that ''the *contract* prevented the sellers from entering into similar arrangements with petitioners' competitors,'' and that the cost justification proviso is, therefore, inapplicable (Resp. Br., pp. 89-90). This contention is falacious. First, the suppliers did *not* contract to grant the allowances exclusively to Fred Meyer (see *infra*, pp. 29-30). Second, since none of the allegedly discriminated against customers purchased in quantities which even approached those purchased by Fred Meyer (Pet. Br., pp. 70-72), the lower prices could not legally have been offered.

The remainder of respondent's argument consists of an assertion that a buyer cannot request a supplier to grant reduced prices in order to conduct a promotional program since the substantially larger quantities purchased would eventuate only by reason of the promotion. The simple answer is that cost justification is an absolute defense and it is of no consequence why a buyer is able to purchase in larger, cost justified quantities. *Automatic Canteen Co.* v. *FTC, supra.* For the same reason respondent's argument that when petitioners requested the reduced prices they did not ''claim them as something to which they were entitled by reason of cost savings resulting from larger purchases'' is of no merit (Resp. Br., p. 90). Indeed, as the Supreme Court has observed, a showing of cost justification must invariably be made by means of studies conducted after-the-fact. *Automatic Canteen Co.* v. *FTC, supra,* at 68-69.[13]

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[13] Respondent's *Cf.* reference to and quotation from *Elizabeth Arden Sales Corp.* v. *Gus Blass Co.*, 150 F. 2d 988, 994 (8th Cir. 1945), *cert. denied,* 326 U.S. 773 (1945), in support of its argument that a price difference cannot be justified by after-the-fact proof that such differences reflected cost savings (Resp. Br., p. 90) is distorted from its context since that case dealt with the question of ''availability'' of Clayton Act Section 2(d) and 2(e) promotional benefits under a claimed but non-existent proportional program.

VI. The Alleged Section 5 Violation

A. The Commission Erred In Finding That Fred Meyer's Suppliers Violated Section 2(d)

As to Tri-Valley and Idaho Canning, petitioners contend that the Commission erred as a matter of law in ruling that the allegedly disfavored customers (Hudson House and Wadhams & Co.) were entitled to equal promotional benefits since they are wholesale customers and do not functionally compete with Fred Meyer, and since there has been no showing that their retailer-customers were "indirect" customers of the suppliers, as this Court held is required in *Tri-Valley Packing Association* v. *FTC,* 329 F. 2d 694 (9th Cir. 1964). Respondent's argument taking issue with the correctness of this ruling is answered at pages 11-15, *supra.*

Additionally, petitioners contend that the Commission's conclusion that Tri-Valley and Idaho Canning violated Section 2(d) is erroneous since, not only have "indirect" customer relationships not been established, but there is no evidence even showing who these "indirect" customers might be, *i.e.,* which retailer-customers of Hudson House or Wadhams competed with Fred Meyer and actually handled, stocked or resold said suppliers' products. Respondent does not argue that such proof exists. Instead, it asserts that such proof is unnecessary and that the indispensable fact can be inferred from a mere showing that Tri-Valley and Idaho Canning sold products to the wholesalers in question and that these wholesalers in turn resold such products, although commingled with identically labeled products of other suppliers and of their own cannery, to their retailer-customers. This, it argues, is sufficient because "the possibility that all [such] products by chance found their way to other areas was too remote for consideration" (Resp. Br., p. 44). The remoteness of the possibility, however, even if of consequence, is not nearly as substantial as respondent asserts.

Hudson House serves approximately 287 "larger customer retail stores", only 127 (45%) of which are actually located in the Portland area (Resp. Br., p. 44). Hudson

House also serves a substantial number of "smaller" retail stores, a large percentage of which are also located outside the Portland area (CX 67A-67Z5; R. 246-47). Likewise, Wadhams serves approximately 80 retail stores, only about half of which are located in the Portland area, plus about 300 additional retail stores through its "cash-and-carry units", of which only three are in Portland (CX 68; R. 265-66). Clearly, therefore, the possibility that Tri-Valley and Idaho Canning products were not distributed to *particular* retail stores in competition with Fred Meyer during the *particular* time period here relevant is not remote, and the Commission's inference that it was "too remote for consideration" is improper.[14] This the Commission itself held in *J. Weingarten, Inc.,* Docket 7714, Opinion of the Commission (March 25, 1963).[15]

Respondent next takes issue with petitioners contention regarding Burlington (Resp. Br., pp. 49-52), first arguing that it is not the date on which promotional benefits were contracted, or the dates on which purchases of commodities in connection with which the promotional benefits were granted were made which establishes the relevant time period, but the "time of the promotion" (Resp. Br., p. 45-46, n. 17; 49). Respondent's position is incorrect. In *Atalanta Trading Corp.* v. *FTC,* 258 F. 2d 365 (2d Cir. 1958), the Court specifically ruled that the time lapse between the *sale* to Atalanta in connection with which the promotional allowances were made and the *sale* to the allegedly disfavored customer precluded a finding of violation.

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[14] The cases cited by respondent (Resp. Br., p. 47) in support of its wholly novel argument that, when a buyer purchases identically labeled commodities from two or more manufacturers and commingles and redistributes them to its customers, the commodities may be deemed to have been purchased from a single manufacturer, are totally inapposite.

[15] "The wholesaler testimony adduced in this record is defective in another respect in that it fails to identify the particular stores serviced which are in competition with Weingarten or, in the instance where stores are shown to compete, there is no showing that these stores handled and sold items similar in grade and quality to those purchased by Weingarten from suppliers who granted it an allegedly discriminatory promotional allowance." *J. Weingarten, Inc., supra,* at p. 8.

However, assuming *arguendo* that the time of the actual promotion is the relevant time period, it is still obvious that Burlington made no sales to Lipman-Wolfe, the allegedly disfavored customer, during such time period. Respondent concedes that, of the hosiery purchased by Lipman-Wolfe from Burlington during 1957, only two style numbers corresponded with those purchased by Fred Meyer (Resp. Br., pp. 49-50). None of these purchases, however, occurred during the period of the coupon book promotion, *i.e.,* the four-week period ending October 23, 1957 (CX 4, 181-86). Similarly, petitioners' promotion in 1958 occurred during the four weeks preceding October 22, 1958 (CX 24). With the exception of a four-dozen purchase of one corresponding style number (style 519), and a seven-dozen purchase of the only other corresponding style number (style 603), Lipman-Wolfe made no purchases of corresponding styles during the period of the 1958 promotion (CX 191-97). Thus, even under respondent's criteria, Lipman-Wolfe made no contemporaneous purchases of relevant goods in 1957 and, in 1958, made such infinitesimal purchases that they cannot be deemed sufficient to support the Commission's finding of violation. *Minneapolis-Honeywell Regulator Co.* v. *FTC,* 191 F. 2d 786, 790 (7th Cir. 1951), *cert. dismissed,* 344 U.S. 206 (1952), *Whitaker Cable Corp.* v. *FTC,* 239 F. 2d 253, 256 (7th Cir. 1956), *cert. denied,* 353 U.S. 938 (1957); *E. Edelmann & Co.* v. *FTC,* 239 F. 2d 152, 155 (7th Cir. 1956), *cert. denied,* 355 U.S. 941 (1958).

Respondent next argues that Burlington's invoice use of corresponding style numbers on two styles of hosiery purchased by Lipman-Wolfe and Fred Meyer establishes that the hosiery was of like grade and quality. However, the private label hosiery purchased for the coupon promotion was manufactured under special specifications prepared by Fred Meyer at the request of Burlington (Pet. Br., p. 48). It being respondent's burden to establish like grade and quality, even should it be correct that invoices establish *prima facie* proof of such, the evidence that Fred Meyer's purchases were under its own specifications de-

stroys any *prima facie* value (see Pet. Br., pp. 47-48).[16] "Antitrust cases," the Commission itself declared in *J. Weingarten, Inc., supra,* at p. 9, and "in particular, Robinson-Patman cases require a meticulous attention to minute details. When dealing with prices, allowances and goods of like grade and quality, the Commission may not indulge in assumptions or presumptions, for these matters are susceptible of exact proof and this is the type of showing which must be made."

Regarding contemporaneous purchases by Roberts Brothers from Cannon Mills, respondent argues that the relevant time period is the period of petitioners' promotion, *concedes that Roberts Brothers made no purchases during this period* (Resp. Br., pp. 52-53), but contends that, although the purchases of towels by Roberts Brothers were one to five months removed from the promotional period, it was proper to infer that Roberts Brothers competed with Fred Meyer in the resale of such towels during the period of the promotion, stating:

> They [petitioners] fail to recognize that just as their purchases were made for later sale, so, inevitably, were Roberts Brothers'. Indeed, since Roberts Brothers, as a department store, was continuously stocking and selling towels, its purchases in April, June, and November clearly were for maintenance of its stock level (Resp. Br., p. 53).

No support is cited for this bald assertion and there is none. Respondent would have the Court find, without evidentiary support, (1) that Roberts Brothers was in fact "continuously stocking and selling towels" and (2) that its April, June and November purchases from Cannon Mills were "clearly" for maintenance of stock level. Even if it should be proper to assume that Roberts Brothers con-

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[16] Respondent also argues that the use of identical invoice designations by Tri-Valley and Cannon Mills establishes like grade and quality of products (Resp. Br., pp. 41, 52). Petitioners, however, as in the case of Burlington, have pointed out that other evidence destroys any prima facie value the invoice designations might have, thus rendering the Commission's inference of like grade and quality improper (Pet. Br., pp. 53-54, 56-57).

tinuously stocked and sold towels, what is there to show that such towels were products of Cannon Mills? The inference drawn is totally lacking in evidentiary support.

The arbitrariness in the Commission's so-called findings in this case is obvious. Cannon Mills' payment to Fred Meyer was 10¢ per dozen towels purchased. In the companion case against Cannon Mills this 10¢ allowance was alleged to have been an illegal price discrimination while here it is alleged to have been part price discrimination and part promotional allowance discrimination. In the *Cannon Mills* case, it was established before the examiner that the full 10¢ was cost justified and the Commission, without reaching the issue of cost justification, ruled that the evidence did not even support a threshold finding of the required probable competitive injury. Respondent now abandons the contention (and its own finding) that Cannon Mills violated Section 2(a) in granting the allowance to petitioners (Resp. Br., pp. 74-75), but maintains that a portion of the allowance violated Section 2(d). How incongruous it is, when considering that 2(d) is a *per se* section because it is assumed that the practices prohibited thereby inevitably result in competitive injury, to indulge in this assumption in the face of a specific finding by the Commission that the same allowance, when challenged under another section, did not result in competitive injury or even create a probability of such.

Petitioners' argument regarding Philip Morris (Pet. Br., pp. 61-66) is that there is no evidence to support a finding of actual disproportionality since, as the Commission itself concedes, "the record is silent as to the comparative volume of purchases by [petitioners] on the one hand and those two non-favored buyers on the other hand . . ." and that "it is impossible to determine whether or not Philip Morris fairly apportioned its promotional money among them" (Pet. Br., p. 63). Ignoring this failure of proof, respondent merely argues that petitioners received "special allowances," that the two allegedly disfavored customers received only "regular" or standard allowances, and that a Section 2(d) violation can therefore be found since there

is no evidence that the allowances received by Fred Meyer were affirmatively offered to such customers, (Resp. Br., pp. 53-57). Assuming *arguendo*[17] that this is correct, it cannot support the finding made. Proportionalization, the Commission has declared, can be accomplished on any basis that fairly proportions benefits among competing customers. FTC Guides for Advertising Allowances and Other Merchandising Payments and Services, 1 CCH Trade Reg. Rep. ¶3980, p. 6076. And in *Vanity Fair Paper Mills, Inc.* v. *FTC,* 311 F. 2d 480 (2d Cir. 1962), the Court, without concerning itself with the nature of the allowances received, found disproportionality because *total* promotional payments—*"special" and "standard"*—granted during a particular year gave the favored customers a larger percentage, based on sales, than the disfavored customers (311 F. 2d at 483). Absent specific proof, therefore, that actual proportionalization was not accomplished, considering *total* promotional receipts, it cannot be concluded that Philip Morris violated Section 2(d).

B. The Commission Erred In Finding That Petitioners Induced And Received Promotional Payments With Knowledge Of Facts Rendering Such Payments Unlawful

Petitioners contend the Commission erred in holding that mere initiation of a promotional program by a buyer places it on notice of illegality and automatically requires affirmative inquiry as to the legality of the payments requested and that such holding is unprecedented and contrary to the Supreme Court's holding in *Automatic Canteen Co.* v. *FTC,* 346 U.S. 61 (1953). Respondent's answer (Resp. Br., pp. 67-71) is that "the ruling is not unprecedented but follows logically from" *Grand Union Co.* v. *FTC,* 300 F. 2d 92 (2d Cir. 1962); *American News Co.* v. *FTC,* 300 F. 2d 104 (2d Cir. 1962); and *Giant Food Inc.* v. *FTC,* 307 F. 2d

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[17] Petitioners do not concede that such affirmative offers were not in fact made. The Philip Morris witness, as respondent notes, had no knowledge whether such offers were made (Resp. Br., p. 56). This same witness, however, testified that allowances of the type granted Fred Meyer were "available" to other customers (Pet. Br., pp. 89-90; R. 536, 538).

184 (D.C. Cir. 1962).[18] In none of these cases, however, was it held that a buyer possesses a duty of making affirmative inquiry merely because it has initiated a particular program. Indeed in *Grand Union* where affirmative inquiry was not even in issue, the test ennunciated was whether "in the exercise of reasonable care" (300 F. 2d at 100) the buyer should have known of illegality. Even in the face of evidence establishing overt coercion of suppliers, the Commission itself declined to find knowledge of illegality simply on the basis of a failure to make affirmative inquiry in the *American News* case (58 F.T.C. 10 (1961)).

Nor does the *Giant Food* case hold that a buyer automatically possesses a duty of affirmative inquiry when he initiates a particular program. There the Court held that the question is whether, "upon the record as a whole, the Commission introduced enough evidence to show that Giant, at the time it induced and received the payments from its suppliers, possessed information sufficient to put upon it the duty of making inquiry. . ." and that want of knowledge could not be pleaded by the buyer, "where it appears that such want of knowledge . . . was culpable" (307 F. 2d at 186-87). The Court went on to find a Section 5 violation by Giant, not merely because it initiated the program, but because Giant had insisted that the payments received were to be over-and-above the regular programs of its suppliers and because the terms of Giant's program were "vague and general", thereby precluding suppliers from formulating programs for other customers (307 F. 2d at 187).

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[18] Respondent also contends (Resp. Br., p. 70), that *R. H. Macy & Co.* v. *FTC*, 326 F. 2d 445 (2d Cir. 1964), is precedent for the Commission's ruling, since the court held that once the Commission proved special payments were made to Macy, it was Macy's burden to show that similar payments were available to its competitors. This holding, respondent asserts, "goes further than but includes the Commission's [ruling] in this case; the burden of proving availability cannot be carried without first ascertaining availability" (Resp. Br., p. 70). *Macy*, however, was in no way concerned with the question of affirmative inquiry. Respondent attempts to equate the necessity of obtaining information for trial with the necessity of affirmative inquiry at the time the allowances were requested. This, of course, is absurd on its face.

Contrary to respondent's contention, it is clear that the Commission's holding in the instant case is diametrically opposed to the Supreme Court's *Automatic Canteen* holding. Automatic Canteen, noted the Court, occupied "a dominant position" in the market, solicited prices which it "knew were as much as 33% lower than prices quoted other purchasers", and did so "without inquiry of the seller, or assurance from the seller" of legality (346 U.S. at 62-63). The Court further pointed out that Canteen "never inquired of its suppliers whether the price differential was in excess of cost savings, never asked for a written statement or affidavit that the price differential did not exceed such savings, and never inquired whether the seller had made up "any exact cost figures' showing cost savings" (*Id.* at 67); that the record "may be taken as presenting varying degrees of bargaining pressure exerted by a buyer on a seller to obtain prices below those quoted other purchasers"; and that in some instances Canteen's method was to "inform prospective suppliers of the prices and terms of sale which would be acceptable to [Canteen] without consideration or inquiry as to whether such supplier could justify such a price on a cost basis or whether it was being offered to other customers of the supplier" (346 U.S. at 65-66).

In both the Seventh Circuit and the Supreme Court, the Commission strenuously urged that under these facts Canteen had a duty of affirmative inquiry and, indeed, the Seventh Circuit agreed and so held (194 F. 2d at 439). In the Supreme Court, the Commission urged over and over that since Canteen initiated and affirmatively induced lower prices it was automatically guilty. Its principal argument, as stated by the Court, was that "buyers who *through their own activities* obtain a special price" can be charged "with responsibility for whatever unlawful prices result" (346 U.S. at 71-72; emphasis added).[19] However, phrased by

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[19] At another point in its opinion, the Court quoted the Commission's argument "that it must now show only 'that the buyer *affirmatively* contributed to obtaining the discriminatory prices *by special solicitation, negotiation* or other action taken by him' " (*Id.* at 77; emphasis added).

the Commission, said the Court, this argument must be rejected as it would render the "knowingly" requirement meaningless (*Id.* at 71); "would comprehend any buyer who engages in bargaining over price" (*Id.* at 72); would put "the buyer at his peril whenever he engages in price bargaining" (*Id.* at 73); and would adversely affect "that sturdy bargaining between buyer and seller" and be inconsistent "with the broader antitrust policies that have been laid down by Congress" (*Id.* at 74).

In dealing specifically with the question of affirmative inquiry by the buyer, the Court noted that any representations by a seller are inherently suspect and unreliable (346 U.S. at 80, n. 24). How illogical and meaningless it is for the Commission to require a buyer to make affirmative inquiry when the response of the seller, whether favorable or unfavorable, would not be something which he, as stated by the Court, "can rely on or should be charged with" and when, because of the very nature of the situation "serious doubts" would exist "as to the weight the assurance [of legality] should be given in support of a buyer's claim" of innocence.

Over and over, the Court in *Automatic Canteen* stressed the necessity for arm's-length bargaining between buyers and sellers in the interest of "broader antitrust policies" and rejected admittedly plausible and permissible interpretations of both statutory language and legislative history "in view of the effect it might have on that sturdy bargaining between buyer and seller for which scope was presumably left" (*Id.* at 73-74). Significantly, this landmark holding was on the basis of a record showing actual dictation of prices by the buyer in a most insistent manner. Obviously, the Commission's holding here that a buyer is required to make inquiry of his suppliers and cross examine them as to the legality of any proposed price or promotional allowance suggested by the buyer is completely at war with *Automatic Canteen.*

Respondent further contends that petitioners knew of the alleged illegality of the supplier payments because of the legend which it claims appeared in "the coupon-book

participation *contracts*'' (Res. Br., p. 72; emphasis added), stating:

> The Commission found (R. 119), and petitioners do not dispute here, that the coupon-book participation contracts contained the provision: ''Offer Must Be Exclusive at Fred Meyer During the 4 Week Period.'' The Commission found (R. 120) that this means that ''each supplier who participated in [petitioners] 'coupon-book' promotion agreed with [petitioners] that it would not, during that particular four-week period of time, 'participate' in a similar program sponsored by any other buyer.'' Petitioners do not dispute that finding here, but argue (Brief 83) that there is no evidence that the contractual requirement was carried out (Resp. Br., p. 72).

This is a misstatement of fact and of petitioners' argument. First, petitioners do not concede that the language meant what the Commission interpreted it to mean (Pet. Br., p. 83). Second, the language was not a contractual provision and was not contained in any contract but appeared in a form letter which was in no sense a contract or agreement (see CX 7, 17) and which most suppliers did not even receive. The letter was *not* presented to Cannon Mills or Burlington (R. 358, 430-31), or to Tri-Valley in 1958 (R. 199-200, 576). As to Tri-Valley in 1957 and Idaho Canning, the evidence is only that the letter may have been presented (R. 194, 208). Respondent's contention that the language ''shows petitioners purpose to obtain. . . discriminatory payments'' is totally unwarranted.

Respondent next passes off as ''scraps of testimony'' (Resp. Br., p. 72) the evidence which petitioners contend establishes that they did not know the allegedly disfavored customers purchased goods of like grade and quality and did not receive or have available proportional allowances. It contends, indeed, that the evidence that petitioners had no knowledge of many of these essential elements, and, indeed, could not have obtained such knowledge, the ultimate issue here, is irrelevant (Resp. Br., p. 72). It is just such refusals to consider the evidence, and the drawing of inferences contrary to such evidence, which peti-

tioners contend requires the "findings" be set aside (see Pet. Br., pp. 82-90).

The ultimate conclusion of the Commission, on both the Section 2(f) and Section 5 Counts, is admittedly based upon an almost never ending series of inferences (see *e.g.,* Resp. Br., pp. 41, 48, 50, 52, 73, 85, 86, 88). It is inferred, in several instances, that Fred Meyer's suppliers sold goods to its competitors in the Portland area; that such sales were of goods of like grade and quality; that sales made to competitors long prior to Fred Meyer's promotion were still stocked by such competitors at the time of the promotion; that the allowances received by Fred Meyer were not proportionalized and created a probability of lessening competition; that such allowances were not cost justified; and, ultimately, that petitioners knew that the sales to inferred competitors of inferred goods of like grade and quality at price differences which created the inferred probability of lessening competition were not cost justified and were not proportionalized. Inferences cannot be so pyramided. *Allen* v. *Trust Co. of Georgia,* 149 F.2d 120 (5th Cir. 1945); *Standard Acc. Ins. Co.* v. *Nicholas,* 146 F.2d 376 (5th Cir. 1944); *Westland Oil Co.* v. *Firestone Tire & Rubber Co.,* 143 F.2d 326 (8th Cir. 1944).

VII. The Commission's Order Is Improper

Respondent's answer to petitioners' contentions concerning the scope of the order is limited to that concerning the order's specific reference to the individual petitioners and to that concerning the inclusion of wholesalers in the Section 5 order (Resp. Br., pp. 91-92). The other contentions, respondent argues, are misdirected since they consist of criticisms of specific phrases used by the hearing examiner in his proposed order (Res. Br., p. 91). While their argument remains substantively unchanged, petitioners admit error in quoting the language from the examiner's order rather than the Commission's final order and restate that portion of their argument which does erroneously refer to the examiner's proposed order.

Accordingly, in the portion of petitioners' argument relating to the Commission's 2(f) order, subparagraph (a) appearing on page 99 of petitioners' brief is deleted. In the portion of the argument relating to the Section 5 order, the second and third full paragraphs appearing under the heading "B. The Section 5 Order," at pages 100-101 of petitioners' brief, are deleted and inserted in lieu thereof is the following paragraph:

> In *Grand Union,* the Court ruled that the Commission's discretion ". . . does not permit an injunction of all violations of the statute just because a single violation has been found." In the present case, instead of being related to the violation found, the order extends to any "service or facilities" furnished by petitioners. Furthermore, while the practice in the present case is narrowly confined to a promotional program involving the "offering for sale" of specific products manufactured by particular suppliers, the order extends to "processing," and "handling," as well as to "offering for sale" of products. The order also extends to *all* products involved in petitioners' promotional activities, *i.e.,* thousands of products, and is not limited to the specific products involved in the Commission's findings of the alleged violation as was the order in the *Quaker Oats* case (see *supra,* p. 98).

With these changes, which do not modify substantively their contentions, petitioners' argument remains as stated in their brief.

CONCLUSION

For all of the foregoing reasons, and for the reasons set forth in petitioners' main brief, it is submitted that the Opinion and Order of the Commission should be set aside.

Respectfully submitted,

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Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Harold F. Baker,
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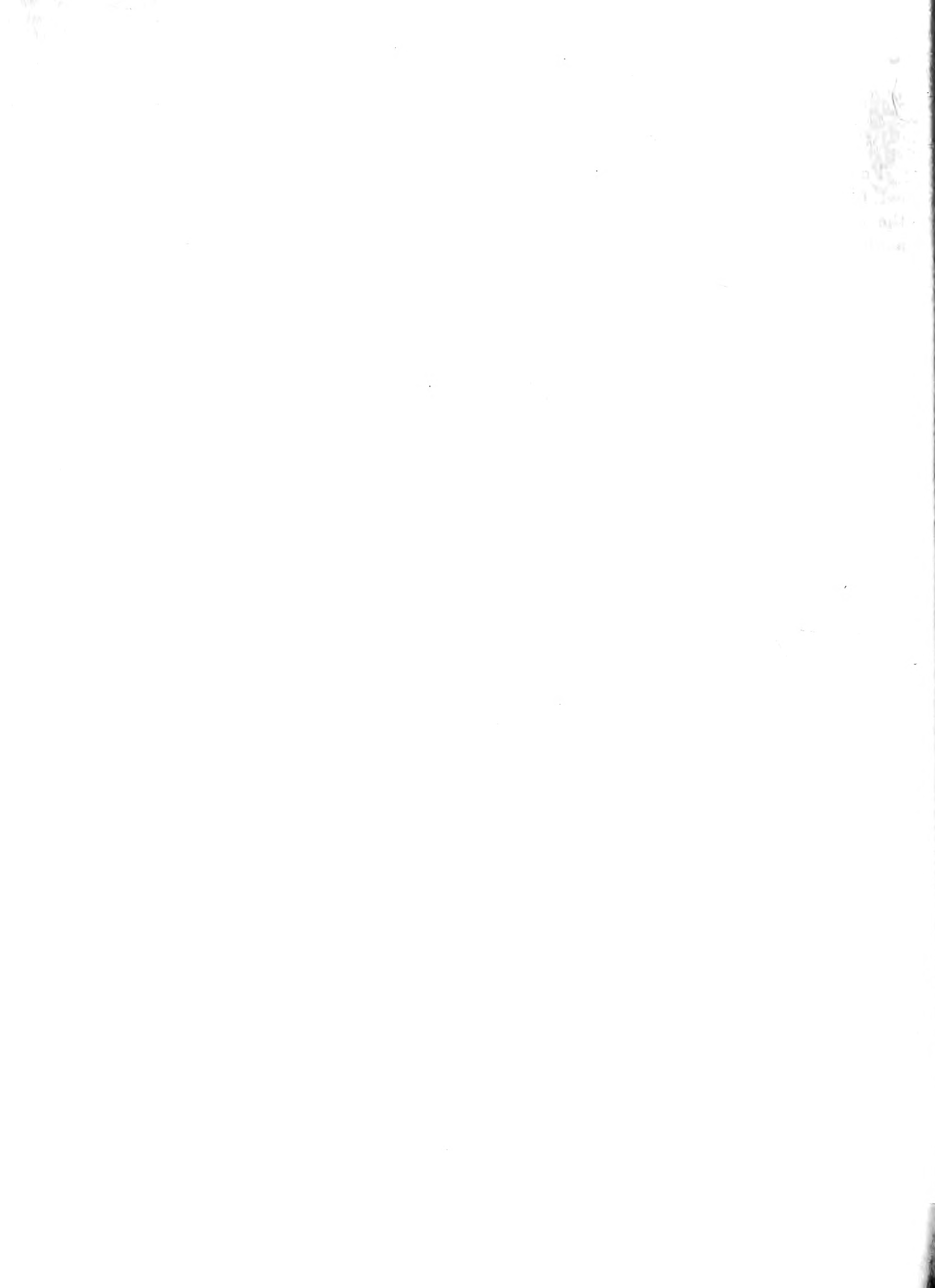

APPENDIX

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Statement by Senator Reed in response to a question by Senator Walsh on the floor of the Senate, 51 Cong. Rec. 15828 (Sept. 28, 1914):

> The Senator says that the section was striken out of the bill by the Senate committee because it was thought that the Trade Commission bill covered the practices. That is true; it was so thought by some of the members; but was the provision reported by the conferees in that shape?
>
> The Senator asks me if I do not think that the conferees were controlled by the same motive as the Senate committee when they went into conference. I answer no, because if they had been they would have allowed the section to stay out of the bill and justified their action on the ground that the matter had been taken care of by section 5 of the Trade Commission bill. On the contrary they said it was not taken care of by Section 5 of the Trade Commission bill when they insisted that it should be again inserted in this bill. It follows they took no such position as was taken by the Senate Committee. * * *

Senator Reed in a discussion with Senator Overman on the floor of the Senate, 51 Cong. Rec. 16154 (October 5, 1914):

> Mr. President, I have heard that argument in various forms. It embraces this idea—that when we passed the Trade Commission bill we did not intend to pass any other legislation. If it had been asserted here that the Trade Commission bill was to be the end of trust legislation at this session of Congress, it would have not passed, and the Senator knows it. On the contrary, it was during the debate on the Trade Commission bill frequently asserted that the Trade Commission bill was to be the mere handmaid of the trust statutes; that it was not to affect or destroy them; that

it was not to hold back other trust legislation. It was iteratively said in reply to those who claimed that the Trade Commission bill was not sufficiently specific or drastic: "Be patient; wait. The Clayton bill is coming on and the Clayton bill does have penalties. Wait for it and your complaint will be met." Now, when it does come on, you turn to us and say: "Having adopted the Trade Commission bill we now propose to murder the Clayton bill."

. . . If the Trade Commission bill was intended to be the end of trust legislation, why did we not stop with it? The friends of that bill have asserted that the phrase "unfair competition" covers every practice injurious to business which is conceivable by the brain of man. If that is true, and if we are to proceed through the Trade Commission, then we should never touch that language. We should not pass the trust provisions of this bill. We should admit we have already completely covered that field by providing a commission enpowered to suppress all evil practices.

But the Senate did not take that view. The Senate committee undertook to say so. The Senate disagreed with the Senate committee as to one section—that relating to tying contracts—and restored it. *Then the conferees put back in the bill the sections of the Clayton bill, thus admitting that the Trade Commission did not cover those practices; for if it did cover them, it was utterly foolish again to inveigh against them. Having thus admitted the necessity of specifying those particular practices,* they then proceeded to remove the criminal penalties.

You cannot hold with the hare and run with the hounds. Driven into a corner you say "In the first place, we did not need any law at all. We had already covered the subject by legislation." Then when asked why you legislated, you say, "Well, it won't do any harm to legislate if you do not say anything when you legislate." That is exactly your position. You cannot sustain this action on any logical ground. *If it be true that these practices were covered by the Trade Commission bill, then that is the end of it.. We ought to stop right there. If you say, on the other hand, that*

> *they were not covered by the Trade Commission bill, then, when we enact law here, let us have a law that does something, and not a law apologized for on the ground that it is unnecessary.* [Emphasis added.]

The Commission's recommended amendment of Section 2 of the Clayton Act in *Final Report on the Chain-Store Investigation,* S. Doc. No. 4, 74th Cong., 1st Sess. (1934), at 96-97, and the Mapes Bill, H. R. 4995, 74th Cong., 1st Sess. (January 29, 1935):

> It shall be unlawful for any person engaged in commerce, in any transaction in or affecting such commerce, either directly or indirectly to discriminate unfairly or unjustly in price between different purchasers of commodities, which commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States.

Statements of Representative Mapes on the floor of the House, 80 Cong. Rec. 8103-8104 (May 27, 1936):

> Early in this Congress, January 30, 1935, to be exact, I introduced the bill as proposed by the Federal Trade Commission having somewhat the same object in view as the Patman bill, now about to be considered. The original Patman bill was introduced on June 11, 1935.
>
> The proposal of the Federal Trade Commission was not as rigid as the Patman bill . . . In substance, it provided that there should be no unfair or unjust discrimination in prices in the selling of commodities to different buyers, and left it pretty largely with the Federal Trade Commission to determine whether the price was unfair or unjust.
>
> Incidentally, it might be of interest to the House to know that this morning the distinguished Chairman of the Federal Trade Commission, Judge Davis, a very

highly respected former Member of this House, appeared before the Committee on Interstate and Foreign Commerce on a bill now being considered by that committee. He told the committee that there had been no amendment to the Federal Trade Commission Act since the passage of the original act creating the Commission in 1914. The Commission is now asking for some amendments to the original act, but for a period of over 21 years no amendment has ever been made to it.

* * *

In further answer to the gentleman from New York, I might say that I have some apprehension that the Patman bill in its present form goes too far and may be too rigid. Personally, I prefer the bill recommended by the Federal Trade Commission, which says that there shall be no unjust or unfair discrimination in price, and leaves the matter of determining the injustice or unfairness to the Federal Trade Commission.

I know that every Member of the House of Representatives has respect for the personnel of the Federal Trade Commission and would be willing to have the law administered by that Commission.

Hearings Before the House Committee on the Judiciary, 74th Cong., 1st Sess., ser. 10, pt. 1, at 254-255 (1935):

6. Would it not be preferable to enact the Mapes bill, H.R. 4995, leaving it to the Federal Trade Commission to determine what discriminations are unjust?

Socrates routed the Sophists of Athens with his question, "What is justice?" and finally himself produced no better answer than that "Justice is justice." The Supreme Court declared invalid for indefiniteness that portion of the wartime Lever Act forbidding "any unjust or any unreasonable rate or charge in the handling or dealing in or with any necessaries" or agreements "to exact excessive prices for any necessaries", *U.S.* v. *Cohen Grocery Co.* (1921) (255 U.S. 81; 65 L. Ed. 516); also a Colorado antitrust act which, after prohibiting combinations in restraint of trade, etc., exempted such

as were necessary to enable the realization of a reasonable profit (*Cline* v. *Frink Dairy Co.* (1927), 274 U.S. 445; 71 L. Ed. 1146).

Unlike "reasonable rates" in public utility regulation, which are related to reasonable costs (which in turn are related to the available market of services and materials concerned) plus a "reasonable return" (which in turn is related to the current market return upon investments of similar risks)—the mere phrases "reasonable" or "just" or "unjust" furnish in the present case no anchoring measure or yardstick either in fact or in principle. If, in the practical administration of such a statute, the Federal Trade Commission were to cast about for such a principle of measure, it would, it is submitted, be compelled to settle upon the principle of measurement by differences in cost as between the customers involved in the discrimination. So long as that is the principle by which the enforcement of the bill must in any case ultimately be guided, it should be incorporated in the bill itself, and not left to adoption by the administrative body charged with its enforcement. For it must be remembered that the validity of a statute for definiteness depends upon the rule therein provided, not upon the rule which some administrative body may choose to employ thereunder.

It must also be remembered that the enforcement of this statute is not limited to the Federal Trade Commission, but that the Clayton Act also confers upon injured parties the right to proceed immediately to a court of law and sue for redress in civil damages. To those whom the bill seeks to protect, this is by far the most important remedy. The Federal Trade Commission's procedure results, at best, in nothing but a cease-and-desist order, which must still be taken to the courts for enforcement, and which in any case affords no reparations nor imposes any penalty for past violations.

Any principle of action by which the administration of this law is to be governed, if it is to be one upon which business can rely for its guidance, must be incorporated in the law itself. It cannot be added by

administrative action thereunder. For the Commission's decisions do not make or settle or build up law, except as they furnish the courts occasion to do so in judicial review. The Commission is not a court. It exercises merely administrative and not judicial power. *Federal Trade Commission* v. *Eastman Kodak Co.* (1927), 274 U.S. 619; 71 L. ed. 1238). While under the present Federal Trade Commission Act it may proceed against "unfair methods of competition in commerce". What legally constitutes such methods is a question that the courts alone, and not the Commission, can ultimately determine. (*Federal Trade Commission* v. *Gratz* (1920), 253 U.S. 421; 64 L. ed. 993; *Federal Trade Commission* v. *Sinclair Refining Co.* (1923), 261 U.S. 463; 67 L. ed. 746.) So also, whether leases, sales, etc., are such as to lessen competition or promote monopoly contrary to section 3 of the Clayton Act, is a question finally for the courts and not for the Commission. (*Federal Trade Commission* v. *Curtis Publishing Co.* (1923), 260 U.S. 568; 67 L. ed. 408.) In each case the Commission can only determine the facts upon the evidence before it and issue its order; but whether those facts legally warrant that order is a judicial question remaining for the courts.

However broad the limits of authority with which this Congress may endow the Commission, it cannot, therefore, build up by its decisions any principles of law or action within those limits. The question before the courts each time is, *Did the Commission act within its power under the law?* If one commission observes limits narrower than those conferred by the statute, a later commission is equally free to broaden them, and a still later commission just as free to narrow them again. To endow the Commission, therefore, with an indefinite latitude of authority, with the hope that it will work out more definite principles of law by its own decisions, is in vain. It can never make the law any more definite than it will be as the Congress now enacts it.

Aside from the above difficulties, the Commission's record of past performances is not such as to inspire

confidence in its aptitude for the application of sound principles of law. Out of 39 occasions in which the Commission's motion has come before the Supreme Court of the United States for review since the Commission's creation, it has been sustained in 16 cases and reversed or overruled in 23 . . .

Final Report on the Chain-Store Investigation, S. Doc. No. 4, 74th Cong., 1st Sess. (1934), at 65:

> It may very well be that a violation of section 2 of the Clayton Act is *ipso facto* an unfair method of competition and therefore a violation of section 5 of the Federal Trade Commission Act. It does not follow, however, that a discrimination in price which falls short of violating the first may be attacked under the second. If the discrimination is actually within the provisos and exceptions of section 2, those same defenses would doubtless be interposed to a proceeding under section 5, with perhaps controlling effect. The wiser course seems to be to treat the price discriminations in favor of chain stores only as a possible violation of section 2, and not as a possibly unfair method of competition. The point cannot be overlooked that if price discrimination was included under the general prohibition of unfair methods of competition when the Federal Trade Commission Act was passed, the latter expression of legislative will in the Clayton Act dealt specifically and in detail with the subject and would therefore seem to take precedence over the more general statutory prohibition.

Statement by Senator Robinson on the floor of the Senate, 80 Cong. Rec. 6335 (April 29, 1936):

> The object of the bill is to prevent large buyers from taking unfair advantage of independents by securing terms that are out of proportion to the differences in cost, thus enabling them to destroy their competitors and to monopolize the market.

Remarks of Congressman Wright Patman, 80 Cong. Rec. 5726 (April 20, 1936):

> The inequities resulting from the present discriminatory practices in merchandising do much more than merely create competitive conditions unfair to the independent merchant. The unequal concessions exacted from manufacturers and processors, through which the favored few benefit, necessarily press backward on costs and tend to keep down or even reduce the wages of workers in those industries.

Remarks of Senator Logan quoted by Senator Alben W. Barkley, 80 Cong. Rec. 6257 (April 28, 1936):

> The evils at which the Robinson-Patman Bill is aimed are the outgrowth of two particular developments in trade and industry during the last 20 years. These are the increase in machine production and the rise of the mass distributor with his large and concentrated buying power . . .

Final Report on the Chain-Store Investigation, S. Doc. No. 4, 74th Cong., 1st Sess. (1934), at 49:

> The "threats" and "coercion" used consisted of statements or intimations that unless the manufacturer would grant the chain special concessions in price, the chain would either buy the goods elsewhere, proceed to manufacture its own, or conduct its stores so as to discourage therein the sale of the recalcitrant manufacturer's goods. If it be admitted that the chain has a legal right to adopt any or all of these policies, it seems to follow that it has a right to announce its intention of doing so unless certain conditions are met. Unless the law be so made or applied as to prevent vertical integration, a chain store may engage in manufacturing. As to buying elsewhere if concessions are not given, it has not been even proposed to deprive the chains of that right. And for a chain in its own stores to encourage or discourage the sale of such goods

as it may choose in its own discretion seems beyond legal attack under any existing law. If an attempt should be made to outlaw the use of such "threats" and "coercion" without also removing the existing legal right to do the things threatened, it would be abortive and ineffective. For it is the manufacturer's recognition that the chain, with its tremendous purchasing and distributing power, may do those things and not the "threat" of the chain to do them that is the real inducement for granting the special concession.

Hearings Before the House Committee on the Judiciary, 74th Cong., 1st Sess., ser. 10, pt. 1, at 31-32 (1935) (from "H.R. 8442, A Bill to Amend Section 2 of the Clayton Act," Specific Questions Answered by H. B. Teegarden):

9. Question. Why does the bill visit its prohibitions upon the manufacturer or other seller if the evil arises principally on the buying side?

Answer. Because the law must help the manufacturer to resist the unfair demands of the large buyer. Every price is made upon the balancing of the gains against the losses which it entails. If in weighing such demands the manufacturer must add on to the loss side his liability for violation of this law, he is so much the less likely to grant what is unfair and what he could not afford to grant all of his customers alike.

10. Question. Will not the bill place an undue burden upon the manufacturer?

Answer. No; because the manufacturer grants these demands only under fear of losing the business to some other competitor who will grant them if he does not. The more able he is made to treat all customers alike, the better and more efficiently he can organize and conduct his business, and the more easily can he do business at a profit, and at the same time grant his customers, and through them the public whom he serves, a share in his economies through reductions in prices.

H.R. Rep. No. 2287, 74th Cong., 2d Sess., at 15-16 (1936):

> Still another favored medium for the granting of oppressive discriminations is found in *the practice of large buyer customers to demand,* and of their sellers to grant, special allowances in purported payment of advertising and other sales-promotional services, which the customer agrees to render with reference to the seller's products, or sometimes with reference to his business generally. . . .
>
> Sections (d) and (e) of the bill address this evil by prohibiting the granting of such allowances, either in the form of services or facilities themselves furnished by the seller to the buyer, or in the form of payment for such services or facilities when undertaken by the buyer, except when accorded or made available to all competing customers on proportionally equal terms. [Emphasis added.]

Remarks of Senator Logan, quoted by Senator Alben W. Barkley, 80 Cong. Rec. 6257 (April 28, 1936):

> The third favorite method of discriminatory abuse lies in the grant of special allowances for so-called advertising or promotional sales services to be rendered by the buyer in the resale of goods which he has purchased from the manufacturer. The buyer, of course, makes his own profit on the resale of those goods. He buys them only for that purpose; and if he doesn't sell them, they become a dead loss on his hands. Yet mass buyers have spun the fairy story that this is a special service to the manufacturer, and that he must pay them extra for doing only what they must do in any case for their own advantage and profit . . .

Representative Greenwood on the floor of the House, 80 Cong. Rec. 8110 (May 27, 1936):

> . . . service allowances and advertising fees used as a subterfuge to give an unjust discount to someone who uses coercion . . .

Statement by Representative McLaughlin on the floor of the House, 80 Cong. Rec. 8127 (May 27, 1936):

> There are three types of discounts used as subterfuges by manufacturers to large purchasers in order to afford to those purchasers a reduction in price as contrasted with the price which the small purchaser is allowed. Those three discounts are advertising discounts, or pseudo advertising discounts, if you will; brokerage discounts or pseudo brokerage discounts, if you will, and quantity discounts . . .

Statement by Representative Michener on the floor of the House, 80 Cong. Rec. 8236 (May 28, 1936):

> . . . that is one of the troubles and discriminations here—that one of these manufacturers will sell to one store, say, a million units, provided they do so much advertising, and then, in turn, will exchange checks and pay the purchaser for doing the advertising, and the advertising consists in hanging up a two by four sign.

Remarks by Representative Utterback, 80 Cong. Rec. 9419 (June 15, 1936):

> This paragraph makes the buyer liable for knowingly inducing or receiving any discrimination in price which is unlawful under the first paragraph of the amendment. That applies both to direct and indirect discrimination; and where, for example, there is discrimination in terms of sale, or in allowances connected or related to the contract of sale, of such a character as to constitute or effect and indirect discrimination in price, the liability for knowingly inducing or receiving such discrimination or allowance is clearly provided for under the later paragraph above referred to.

Hearings Before the House Committee on the Judiciary, 74th Cong., 1st Sess., ser. 10, pt. 1, at 31 (1935) (from

"H.R. 8442, A Bill to Amend Section 2 of the Clayton Act," Specific Questions Answered by H. B. Teegarden).

> 6. Question. Why does the bill pick out quantity prices, brokerage and advertising allowances for suppression?
>
> Answer. Because these are the three favorite disguises under which large buyers wring their exactions.

Final Report on the Chain-Store Investigation, S. Doc. No. 4, 74th Cong., 1st Sess. (1934), at 59-60:

> The term "preferential treatment" as used here means that treatment granted to chain stores but not given to other retail dealers, which results in a lower net cost to chain-store customers than to other retailers. These preferential treatments usually take the form of special discounts and allowances, sometimes given in consideration of promotional sales work or special service rendered by the chain-store receiving the concession. . . . Where preferences are granted in the form of promotional allowances without the rendition of services in return, they are, in effect, price concessions having no direct relation to quality of goods, quantity purchased, or cost of selling.

Statement by Senator Culberson on the floor of the Senate, 51 Con. Rec. 13849 (Aug. 17, 1914):

> Mr. CULBERSON. Mr. President, when the Committee on the Judiciary made their report on this bill, they proposed a number of amendments to section 2. Since then the Federal trade commission bill has passed the Senate and is now in conference. Under that bill all questions affecting unfair competition are to be submitted to that tribunal. I am now authorized by the committee to abandon the amendments to section 2, and to move in lieu thereof that the entire section 2 be stricken out, for the reason that the general subject embraced in that section can be dealt with by the

Federal trade commission, as provided for in the trade commission bill.

The Presiding Officer. The question is on the motion of the Senator from Texas to strike out section 2.

The motion was agreed to.

Statement of Representative Floyd on the floor of the House, 51 Cong. Rec. 16317-16318 (Oct. 8, 1914):

> . . . I desire to take up now briefly that part of the report covering sections 2, 3, and 7. The first relates to discriminatory contracts, the second relates to tying or exclusive contracts, and the third to holding companies. It will be observed that these sections deal with contractual relations in commercial dealings . . . Why the necessity of restoring these sections without penalties? In justice to the Senate of the United States let it be said that after section 5 of the Trade Commission bill had passed that body and had been approved by the House, condemning as unlawful all unfair methods of competition, the theory of the Senators was that these unfair methods would be included and cared for under the provisions of the Trade Commission bill. But that was not the view of your managers on the part of the House. Your conferees believed that in dealing with these contractual relations, the Supreme Court having held that Congress has the power to declare null and void any contract that substantially interfered with interstate commerce, but that the courts have no such power in the absence of an act of Congress condemning them, such contracts would be upheld in the future, not only by the commission but by the courts, until the legislative power of this Government declared them to be unlawful. We insisted that those three provisions be placed back in the bill, and finally they were placed back in the bill without the penalties. . .

No. 18,904

United States Court of Appeals

For the Ninth Circuit

MARINE MIDLAND TRUST COMPANY, etc., et al., *Appellants,* vs. CITY OF NORTH SACRAMENTO, etc., *Appellees.*	}

BRIEF OF APPELLANTS

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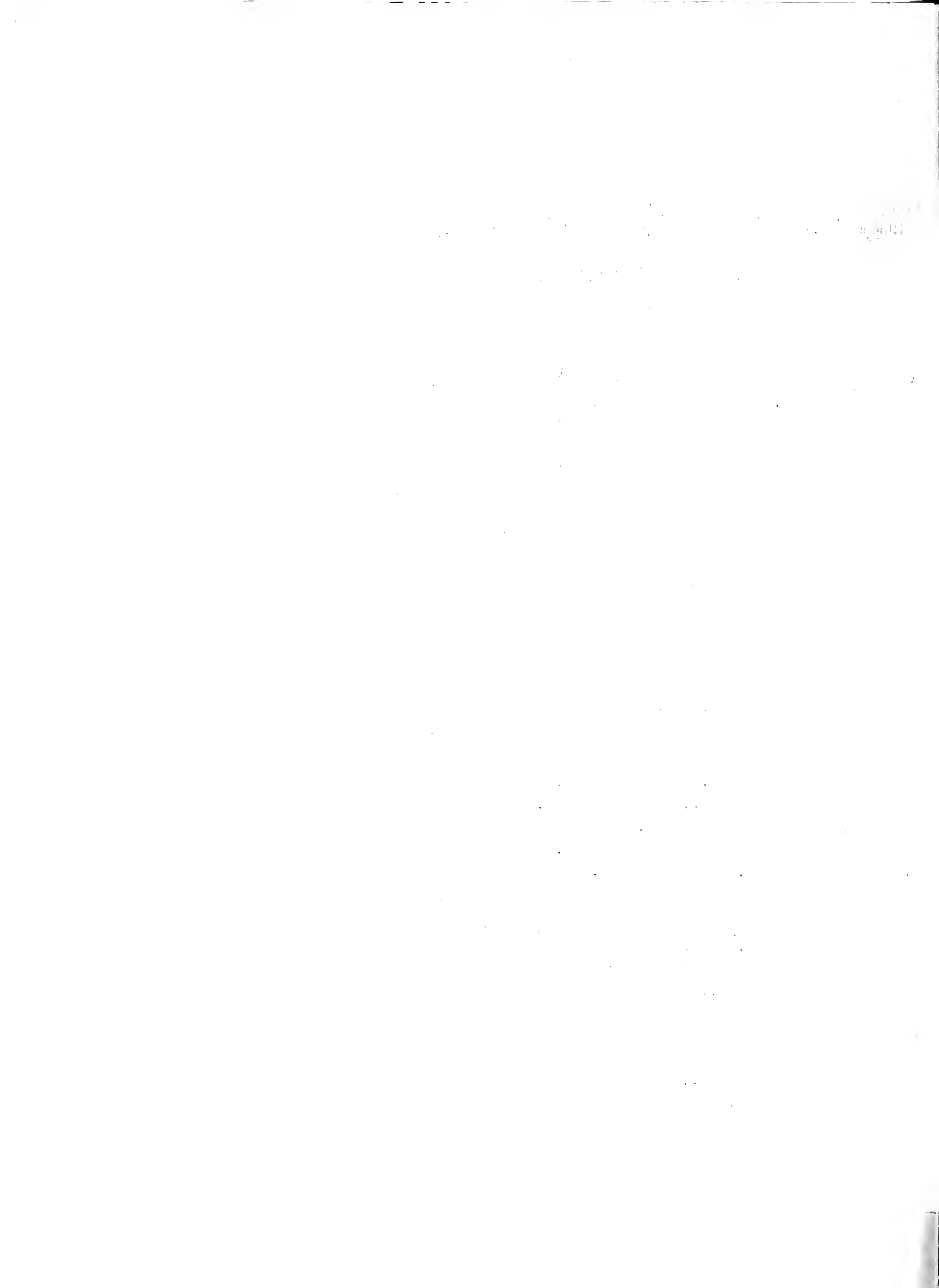

No. 18,904

United States Court of Appeals

For the Ninth Circuit

Marine Midland Trust Company, etc., et al.,
Appellants,
vs.
City of North Sacramento, etc.,
Appellees.

BRIEF OF APPELLANTS

STATEMENT

Plaintiffs - Appellants (hereinafter "Plaintiffs") appeal from a judgment (Tr. 57[1]) of the United States District Court for the Northern District of California (Halbert, J.) dismissing the Complaint herein for failure to state a claim upon which relief can be granted.

The jurisdiction of the District Court had been invoked under 28 U.S.C.A. § 1332 and relief was sought pursuant to the Federal Declaratory Judgment Act, 28 U.S.C.A. §§ 2201, 2202. The Complaint (Pars.

[1]Numbered references are to pages of the *Transcript of Record* except where otherwise indicated.

1-8[2], Tr. 1-2) alleged diversity of citizenship of the parties; that the amount in controversy exceeded $10,000; and that there was an actual and justiciable controversy between the parties which had led to the existence of an uncertain and disputed jural relationship.

This Court's appellate jurisdiction is invoked pursuant to 28 U.S.C.A. § 1291.

THE COMPLAINT

For purposes of reviewing a judgment of dismissal on the pleadings, the allegations of the Complaint are ordinarily to be accepted as fact.[3] The rule is particularly applicable to this case where the District Court, shortly prior to granting the motion for judgment on the pleadings, has denied defendants-appellees' (hereinafter "Defendants") motion for summary judgment because of the presence of material issues of fact (Tr 39).

The first count of the Complaint seeks an *in personam* declaratory judgment against defendants stating that the deposit of $2,206,000 made by defendants "is subject to claims on behalf of various persons and, therefore, is disqualified to serve as an effective payment and as a predicate for a transfer of title

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[2]Paragraph references ("Par.") will hereinafter be to paragraphs of the Complaint unless otherwise specified.

[3]See *Dann v. Studebaker-Packard Corporation*, 288 F.2d 201, 215-16 (6th Cir. 1961) and cases therein cited.

and possession [Citizens Utilities Company of California's] water system to defendant City [of North Sacramento] (Par. la; Tr. 23)." The gravamen of the Complaint allegations underlying this prayer are as follows:

Plaintiffs are Trustees under an Indenture of Mortgage and Deed of Trust executed by Citizens Utilities Company of Delaware ("Citizens"). Plaintiffs are the pledgees of 100% of the stock of Citizens Utilities Company of California ("Citizens of California"), a wholly owned subsidiary of Citizens and the owner of the water system condemned by Defendant City of North Sacramento ("City").

Plaintiffs are entitled, under the terms and provisions of the Indenture of Mortgage and Deed of Trust, to receive all of the proceeds resulting from condemnation of property of Citizens of California.

Plaintiffs received a telegram from defendant City, signed by its Mayor, defendant Roth. The telegram advised of the deposit by the City in the Superior Court of the State of California in the sum of $2,206,-000.00 on account of condemnation of properties of Citizens of California. Plaintiffs instituted an investigation to determine the circumstances surrounding the making of the deposit.

Plaintiffs' investigation disclosed that Defendant City had condemned the North Sacramento water system of Citizens of California; that defendant City had offered for sale and sold certain *revenue* bonds to finance the acquisition thereof; and that the money

deposited in the Superior Court was derived entirely from the proceeds of that bond issue.

It further appeared that defendants had been guilty of improper and unlawful conduct in the solicitation for the sale and in the sale of the revenue bonds. In particular, defendant City had misrepresented as a fact to the bond purchasers that the proceeds of the bond issue would be sufficient to cover the acquisition cost of the water system as well as other necessary costs. The City had also failed to disclose to the bond purchasers certain material, adverse facts, namely, that pending annexation proceedings posed a threat to the financial integrity of the bonds, which were repayable solely from the revenues of the water system and were not in any way an obligation of defendant City; that California law required a condemnor to pay interest on the amount of the condemnation award from the date of Interlocutory Judgment until the taking of possession, which in this case aggregated over $350,000; that additions and betterments to the water system, for which the City would have to pay, were of a value greatly in excess of the amount stated by the City to bond bidders; and that the City might be obliged to pay additional moneys on account of appreciation to the value of the water system between the date of valuation thereof by the California Public Utilities Commission and the date of taking possession.

It also appeared that although defendants were not entitled to proceed to a closing of their bond issue until certain litigation had been completely settled—

until the bond buyer had complete assurance that such litigation could not possibly pose a threat to the ability of the City to repay principal and interest from revenues of the system alone—defendants nevertheless induced such a closing to occur, in violation of their contractual arrangement with their bond purchaser, by means of a false "no-litigation" certificate which was made and delivered to the bond buyer.

In view of the foregoing, and other matters detailed in the First Count of the Complaint, it clearly appeared that the bond buyer, and its transferees, among others, had rights of action against defendant City for rescission of the purchase, for damages, and otherwise. By the same token, the money received by the City from the defrauded bond purchaser was money burdened with these claims—tainted money. By reason of plaintiffs' knowledge of the circumstances of the City's obtaining that money, if plaintiff's were to take or receive that money, they would subject themselves to liability therefor if actions were to be commenced by the aggrieved parties.

In this posture, rather than take money which is tainted money—money which is affected with outstanding claims, and thereby subject themselves to liability for its return or for damages for its detention or other forms of suits, plaintiffs came before the District Court, on the ground of diversity of citizenship, and prayed that said Court make a declaratory judgment adjudicating the rights and obligations of the parties in the premises. Specifically, a declaration was prayed that the money on deposit in

the Registry of the Superior Court of the State of California is not money which can be tendered in payment of the obligation which it purports to discharge, by reason of its tainted nature, and that as a result plaintiffs are not required to accept it.

The Second Count of the Complaint brought before the District Court plaintiffs' claim, as Trustees, that the taking of property which stood as collateral security for indebtedness owed to the people they represent, Citizens' bondholders, is an unconstitutional taking of property which directly and materially decreases the security for the indebtedness for which plaintiffs stand as Trustees.

THE OPINION BELOW

The opinion of the District Court (Halbert, J.) dismissing the Complaint herein appears at Tr. 47-54. The lower court held (Tr. 50) that "in an action of the present type, . . . the diversity jurisdiction of the federal court [does not] require that this Court afford relief to plaintiffs."

Central to this decision below was the District Court's conclusion that the California Superior Court had "*inferentially* found against" the contentions advanced in the instant Complaint in the previously instituted condemnation proceeding, to which City and Citizens of California—but not plaintiffs—were parties. (Emphasis added.) In reaching this conclusion, the lower court relied—apparently exclusively—on the description of the state court condemnation proceed-

ing contained in the pleadings (Tr. 51-53); the Court made no reference to any extrinsic evidence relating to or going beyond the face of the state court judgment of condemnation.

Moreover, the lower court expressly noted in its opinion that its decision assumed the standing of plaintiffs, as pledgees, to bring this action (Tr. 50), and that the prayer for relief based on Count II of the Complaint, seeking to set aside the judgment of condemnation, could not operate to bar plaintiffs' right to relief if such right existed under the allegations set forth in Count I of the Complaint (Tr. 50-51).

QUESTIONS PRESENTED

1. Was it error for the court below to have dismissed the Complaint herein for failure to state a claim?

2. Did the diversity jurisdiction of federal courts which the court below, for purposes of its decision herein, assumed had been properly invoked in the first instance by plaintiffs, require that the District Court entertain the Complaint?

3. Particularly in view of the absence of any extrinsic evidence concerning the facts adjudicated by the state court judgment which the District Court held constituted a bar to this action, did the court below commit error in assuming that the aforesaid state court action—to which plaintiffs were not party—"inferentially found against" the contentions of the Complaint?

4. Was it error for the lower court to hold that the decision in *Thibodo v. United States,* 187 F.2d 249 (9th Cir. 1951) should be construed as barring plaintiffs' right to relief on the allegations contained in the Second Count of the Complaint?

ARGUMENT

POINT I

THE COMPLAINT SETS FORTH A JUSTICIABLE AND VALID CLAIM TO RELIEF.

In accordance with the law and the facts alleged in the Complaint, if plaintiffs were to receive the money deposited by defendants, they would be exposed to liability on that account to those persons who were misled by the misrepresentations complained of. Innumerable decisions hold that one who receives money with notice of the fact that the money so received is subject to the claims of a third person will be responsible for the return of the money to the aggrieved third person. See, *e.g.:*

> *Pollak v. Staunton,* 210 Cal. 656 (1930), 293 P. 26;
>
> *Sasner v. Arnsten,* 93 Cal. App. 2d 467 (1949), 209 P.2d 44;
>
> *California Bank v. Diamond,* 144 Cal. App. 2d 387 (1956), 301 P.2d 60;
>
> *Rudin v. Kong-Richardson Co.,* 37 F.2d 637 (7th Cir. 1930).

This conclusion is reinforced by the lower court's earlier decision denying defendant's motion for summary judgment, which establishes that, on the present

record, there exist material issues of facts which, when resolved in plaintiffs' favor would entitle plaintiffs to relief.

The relief to which plaintiffs are entitled includes the remedy of a declaratory judgment. There can be no question but that were plaintiffs to receive the money deposited by defendants they would be exposed to liability to the persons who relied on the misrepresentations made by defendant City, as alleged in the Complaint. In this posture, it is clear that plaintiffs need not accept the money and then assume the risk of being named defendants in lawsuits by bond purchasers. Authorities make it clear that plaintiffs are entitled, at this stage of proceedings, to bring this declaratory judgment action for an adjudication of their rights and obligations so that they may avoid the necessity to take such steps as will necessarily expose them to liability.

The broad and remedial purpose of the Declaratory Judgment Act, and the need for a liberal interpretation thereof, is fully set forth in *Simmonds Aerocessories v. Elastic Stop Nut Corp.,* 257 F.2d 485 (3rd Cir. 1958). Moreover, in *Dewey & Almy Chemical Co. v. American Anode, Inc.,* 137 F.2d 68 (3rd Cir. 1943), cert. denied 320 U.S. 761, the court stated (at pp. 69-70):

> "In providing the remedy of a declaratory judgment it was the Congressional intent 'to avoid accrual of avoidable damages to one not certain of his rights and to afford him an early adjudication without waiting until his adversary should see fit to begin suit, after damage had accrued.'

> * * * This court has emphasized that the Act should have a liberal interpretation, bearing in mind its remedial character and the legislative purpose."

Similarly, in *Scott-Burr Stores Corp. v Wilcox,* 194 F.2d 989 (5th Cir. 1952), the court indicated that the Declaratory Judgment Act is available for settling controversies "before they ripen into violations of law or breach of contractual duty."

As hereinabove noted, plaintiffs' standing to maintain this action was conceded by the decision below, notwithstanding that the greater part of defendants' argument on both their motion to dismiss and on their prior motion for summary judgment was directed to the proposition that plaintiffs lacked such standing. The grounds for the lower court's decision on that score were set forth in its January 30, 1963 Memorandum and Order (Tr. 43-45) and are clearly correct. Other decisions amply reinforce the lower court's initial conclusion that plaintiffs, as the pledgees of the stock of Citizens of California, have standing to protect their security against impairment by the acts of the defendants. See, *e.g., York Properties, Inc. v. Neidoff,* 170 N.Y.S. 2d 683,[4] where the court stated:

---

[4]Note that New York decisions are particularly significant in the present situation inasmuch as the stock of Citizens of California pledged to plaintiffs was stock pledged in the State of New York and the Trust Indenture regulating such pledge was executed in and is governed by the laws of the State of New York. Under these circumstances it would appear that, pursuant to traditional rules of conflicts of law, the laws of the State of New York would be controlling in respect of a pledgee's standing to maintain this action. See *Miller v. Wahyou,* 235 F.2d 612, 615 (9th Cir. 1956).

"A pledgee of corporate stock who receives an assignment of shares has a security for a debt as a right therein to the full extent necessary to protect the indebtedness, and may sue in equity to preserve the corporate property and to prevent its passing out of the hands of the corporation (Campbell v. American Zylonite Co., 122 N.Y. 455; see Fletcher, Cyclopedia of Corporations, Vol. 12A, § 5651)." (Emphasis added.)

See also *Cannon v. Parker,* 152 F.2d 706, where, in a situation in many ways analogous to the instant case, the right of a pledgee of stock to institute an action was upheld in the following language (at p. 709):

"The appellees [pledges of stock in question] were not creditors of the . . . . corporation, but of Cannon [the pledgor, whose position is analogous to Citizens Utilities, Inc., the parent company]. Their relationship to the corporations was solely that of stockholders by endorsement and pledge by Cannon of shares of stock. . . . Nor were they suing Cannon to collect their debt, which was not in default. They had a long term investment drawing monthly interest which they wished to preserve. Their aim was to maintain the integrity of the corporate assets and restore what had been misapplied."

Moreover, the lower court's aforesaid January 30, 1963 Memorandum and Order aptly suggested as an applicable analogy to our situation the case of *Consolidated Water Co. v. City of San Diego,* 89 Fed. 272 (C.C.S.D. Cal. 1878), in which it was held that a mortgagee has standing to sue in his own right without

first making demands of the corporate mortgagor. The parallel between a creditor such as the mortgagee and one whose claim is secured by pledge (such as plaintiffs herein) is complete. This proposition is recognized by the New York cases as well. See *East River Savings Bank v. State,* 266 App. Div. 494, 43 N.Y.S.2d 703 (3rd Dep't 1943), where a mortgagee bank, as equitable owner of land, was held entitled to bring a suit for damages in a condemnation proceeding pursuant to a statute allowing "any owner" to assert a claim, notwithstanding that the legal owner had previously approved a settlement in respect of the condemnation. Cf. *Bunyan v. Commissioner of Palisades Interstate Park,* 167 App. Div. 457, 153 N.Y. Supp. 622 (3rd Dep't 1915) (corporate bondholders held not obliged to apply to corporation as prerequisite to bringing their action).

POINT II

THERE IS NO BASIS IN LAW OR FACT FOR THE DISTRICT COURT'S CONCLUSION THAT THE STATE COURT CONDEMNATION ACTION— TO WHICH THE PLAINTIFFS WERE NOT PARTY—"INFERENTIALLY" CONSTITUTED A DETERMINATION ADVERSE TO THE ALLEGATIONS SET FORTH FOR THE FIRST TIME BY THE PRESENT COMPLAINT.

The decision of the court below, dismissing a Complaint otherwise assumed to be meritorious, was premised on that court's assumption that the decision of the California Superior Court in the condemnation action entitled *City of North Sacramento v. Citizens Utilities Company of California,* included a deter-

mination "inferentially" adverse to the allegations of the instant Complaint. From this assumption followed the District Court's conclusion that the present action must be barred as constituting a collateral attack on the state court judgment.

It is clear, however, that the questions raised by the allegations of the instant Complaint were not, in fact, need not have been, and ordinarily would not have been considered or in any way passed upon by the California Superior Court in the said condemnation action. In this connection it should be noted that the District Court, in reaching its aforesaid conclusion, placed exclusive reliance (Tr. 52-53) on the following portion of the findings and judgment of the California Superior Court:

> "that plaintiff [City] has already paid into court for defendant [Citizens of California] the sum of Two Million Two Hundred Six Thousand Dollars ($2,206,000) as the just compensation fixed in the Interlocutory Judgment . . ." (Final Order, page 1, Exhibit D to City's answer in the present action),

and that based upon said payment,

> "It Is Ordered, Adjudged and Decreed:
>
> I
>
> "That said condemnation and taking provided for in said Interlocutory Judgment of Condemnation in said proceeding is complete and final: plaintiff [City] fully has and owns the lands, properties and rights sought in said proceeding . . ." (Final Order, page 1.)

There was no extrinsic evidence whatsoever before the District Court—nor did any such evidence exist—indicating that any of the issues raised by the instant Complaint as to the improprieties associated with the bond issue precedent to such deposit of money, had been passed upon, considered by, or were known to the California Superior Court.

Under these circumstances, it is respectfully submitted that there exists no basis in law or in fact for the lower court's conclusion that the instant action represents a collateral attack on a state court judgment.

A. The Issues Raised by the Complaint Herein Are Not Such as Would Normally Be Dealt With or Concluded by a California Judgment of Condemnation.

The instant Complaint raises, *for the first time,* questions concerning the propriety of the methods by which defendants raised certain funds. The complainants' standing to seek the relief prayed for herein derives from the fact that, absent such relief, they will be the ultimate recipients of the funds alleged to have been improperly raised and will themselves be subject to rescission actions by bond purchasers. The fact that the proceeds of an improper bond issue were ultimately deposited with the California Superior Court is in no way related to or exculpatory of the misrepresentations (as alleged in the instant Complaint and admitted as true for the purposes of this motion) which were made in connection with such bond issue.

As one indication of the complete lack of any such relationship, plaintiffs point out that they have been unable to locate any California condemnation decisions wherein this type of impropriety was raised before or dealt with by the California courts in similar condemnation proceedings.

Moreover, it is clear that the normal procedure followed in California condemnation cases is such that the issues raised by the instant Complaint would *not* ordinarily be passed upon by the California condemnation courts. A condemnation proceeding of the kind relied upon herein by the District Court to bar plaintiffs' right to relief is normally commenced under the Public Utilities Act by filing of a petition with the Public Utilities Commission. Such petition sets forth the intention of a political subdivision to acquire land under eminent domain proceedings (Public Utilities Act, § 1403). Thereafter, an order to show cause is made by the Commission which specifies the owners and claimants named in the petition and directs them to appear before the Commission at a specified time and place to show cause why the Commission should not proceed to hear the petition and fix just compensation (Public Utilities Act, § 1405). After the order is served (Public Utilities Act, §§ 1406-1407) with a notice of hearing, the hearing is held at the time and place specified in the order (Public Utilities Act, § 1409). When the proceeding is terminated, the Commission fixes, in written findings, the amount of just compensation to be paid by the political subdivision for the property as of the

day on which the petition was filed with the Commission (Public Utilities Act, § 1411). Within 20 days after the Commission has made and filed its findings, the owner of the property may file a stipulation consenting to accept the just compensation fixed by the Commission (Public Utilities Act, § 1412). If the owner does not so consent, the political subdivision commences an action in a court of competent jurisdiction to take such property under eminent domain proceedings (Public Utilities Act, § 1413). The court in which such action is commenced is bound, however, by the finding of the amount of compensation fixed by the Commission, and decides only whether "the political subdivision has the right and power under the law to take the lands, property and rights" (Public Utilities Act, § 1416).

The findings which the court must make in this connection are specified at length in § 1241 of the California Code of Civil Procedure. At no point is the court required to determine whether the money deposited for the property is free of claims. After the court has determined that the political subdivision has the *right* and *power* to condemn the property and has fixed the compensation at the amount set by the Commission, it enters an original (i.e. "interlocutory") judgment which states that "upon the payment of the just compensation fixed in the original judgment of condemnation the plaintiff in the action shall be entitled to immediate possession of the lands, property and rights" (Public Utilities Act, § 1419). When, in fact, payment is made either to the owner or

deposited with the court (Code of Civ. Proc., § 1252), the final judgment of condemnation is entered entitling the political subdivision to immediate possession.

Nothing in such proceedings requires or permits the Commission or the condemnation court to make a finding as to whether the money paid to defendants or deposited in the court is free from claims.

It follows that the contention of plaintiffs herein—that the sale of the City's bonds to First Boston was improper and that consequently the money obtained by such sale was tainted—can not be assumed to have been considered by the California Superior Court.

B. Assuming Arguendo, and Contrary to the Fact, That Findings Made by the California Superior Court in an Action to Which Plaintiffs Were Not Party Could Serve as a Bar to Plaintiffs' Otherwise Concededly Valid Claims Herein, Defendants Have Not Sustained Their Burden of Establishing That Such Findings Were, in Fact, Made by the California Court.

In its opinion dismissing the Complaint the lower court relied on findings which it *assumed* had been made by the California Superior Court. However, the foregoing discussion has quite clearly established that such findings had not *necessarily* been included in the state court's judgment of condemnation. If, in fact, the California Superior Court was even empowered to make such findings in a proceeding of the kind that was before it, then pertinent decisions show beyond any question that the burden of conclusively demonstrating to the District Court that such find-

ings had been made necessarily rested upon defendants.

The existence of this burden, as well as of the fact that defendants have failed to meet it, is well illustrated by the decision in *Johnston v. Ota,* 43 Cal. App. 2d 94 (1941), 110 P. 2d 507. In the *Johnston* case, the lower court had sustained a plea of *res judicata* in an action alleging breach of a lease agreement, relying for its decision on a copy of the judgment in an earlier case *in the same court, which had been attached as an exhibit to the answer.* The lower court purported to take judicial notice of the contents of the judgment roll without receiving any formal proof relating thereto. The appellate court reversed, stating (at pp. 97 and 98):

> "It must appear either upon the face of the record or be shown by extrinsic evidence that the *precise issue* raised in the second action was determined in the former suit. (Russell v. Place, 94 U.S. 606 [24 L. Ed. 214])." (Emphasis added.)
>
> "* * * The fact that the Judgment was attached as an exhibit to the answer, merely establishes its genuineness and due execution. (Code Civ. Proc., Sec. 448). It does not prove the matters adjudicated by the judgment of dismissal."

Similarly, in the case of *Garcia v. Venegas,* 106 C.A.2d 364, 235 P.2d 89 (1951), the California appellate court stated (at 106 C.A.2d p. 371):

> "The former judgment was rendered by a justice's court. The only evidence concerning that judgment and the action in which it was rendered is a document certified by the justice of the peace

as a transcript of the pleadings and proceedings as appeared from his docket. This document contains none of the pleadings. It indicates that appellant herein was the plaintiff and respondent herein the defendant, that a complaint for forcible detainer was filed and summons issued August 5, 1947; that the action came on for trial on October 1, 1947; and recites, 'it is ordered, adjudged and decreed that the Plaintiff do have and recover of and from the said defendant the sum of $55.00 debt and $5.50 costs, and that plaintiff have restitution of the premises.' It does not identify the premises, nor does it demonstrate that title to real property was or could have been involved or adjudicated in the former action. A justice's court may try title to real property when 'properly involved' in a forcible entry or forcible or unlawful detainer action as provided in subdivision 1(b) and 2(b) of section 112 of the Code of Civil Procedure. The issue of title is 'properly involved' in such an action in the narrowly limited situations described in *Cheney v. Trauzettel,* 9 Cal.2d 158 [69 P.2d 832], and *Higgins v. Coyne,* 75 Cal. App. 2d 69 [170 P.2d 25]. The meager recitals in the justice's court judgment which appellant invokes are insufficient to show that respondent's right, title, and interest in the property (even if it were the property mentioned in the complaint herein) was or could have been 'properly involved' and adjudicated in that action. The necessary elements of estoppel by judgment are lacking."

See also to the same effect *Babcock v. Babcock,* 63 C.A.2d 94, 146 P.2d 279 (1944) ("The burden of prov-

ing that it [a factual issue allegedly determined in an earlier case] was tried and determined was, of course, upon the defendant"); *Emerson v. Yosemite Gold Mining Co.,* 149 Cal. 51, 57 (1906), 85 P. 122.

The foregoing cases very explicitly establish that a party asserting the existence of an estoppel through a prior judgment has the burden of proving that the precise issue in the case at bar actually was litigated and determined in the earlier suit. Nothing in this record indicates that defendants have, in any way, met such a burden.

C. In Point of Fact the Issues Raised by the Instant Complaint Were Not and Could Not Have Been Passed Upon by the California Superior Court.

After "just compensation" had been fixed in the state condemnation proceeding by the Public Utilities Commission at $2,206,000 (Par. 20), the Superior Court entered an Interlocutory Judgment which decreed that City had the right and power to take the lands in question. To the extent that such judgment is properly before this Court (and without conceding that it is) plaintiffs point out that said judgment was "interlocutory" in only one respect: as a precondition to the entry of final judgment, City was obligated to pay the amount of $2,206,000 to Citizens of California or deposit such amount in court. Thus, the Interlocutory Judgment provided in Paragraph VIII thereof:

> ". . . upon payment of the $2,206,000, subject to modification as provided in Paragraph VI above, to the defendant, or deposit of the moneys in

Court for the defendant, the Court shall enter a final order of condemnation adjudging and decreeing that the said condemnation and taking shall be complete and final and that plaintiff (i.e. City) shall fully have, own and possess the lands, properties and rights sought in this proceeding comprising the municipal water system referred to in Paragraph IV hereof for the uses and purposes set forth in the Complaint herein."

The "modification" pursuant to the provision therefor in Paragraph VI, was as follows:

"That the just compensation to be paid for the said lands, property, and rights is the sum of $2,206,000, which sum is subject to modification by reason of such increase or decrease as may hereafter be certified to this Court by the Public Utilities Commission of the State of California as provided by Sections 1416 to 1419, inclusive, of the Public Utilities Code."

Paragraph VII went on to make clear, in the following language, that such modification would not, in any event, stay the final judgment of condemnation:

"That the filing of petitions to the said Public Utilities Commission for increase or decrease of the just compensation shall not act as a stay of this judgment in condemnation, but, as provided in section 1419 of the Public Utilities Code, upon the payment of the sum of $2,206,000, the plaintiff herein shall be entitled to immediate possession of the said lands, property, and rights."

Therefore, as of the date of entry of the Interlocutory Judgment, November 5, 1959, no determination

was made, or could possibly have been made, concerning the question of whether the money later deposited in the registry was "tainted." This is so because, as hereinabove stated, the money had not yet even been deposited and because all of the events, as a result of which it is alleged that the money became tainted, i.e., the misrepresentations by defendant City to First Boston Corporation and Associates, occurred in the months of March, April and May of 1962, two and one-half years after such date (Complaint, Pars. 26 *et seq.*). Specifically, it was only on March 19, 1962 that the City Council of defendant City adopted the resolutions providing for the issuance of the bonds, authorizing their sale and setting the date for receiving bids (Par. 26 of the Complaint; admitted in Par. 10 of the Answer). It was at this time that First Boston Corporation officially made known its interest in the purchase (Complaint, Par. 26, *et seq.*). And it was thereafter, up to and including May 17, 1962, that the alleged misrepresentations, misleading statements and failures to disclose occurred which gave rise to the disputed jural relationship which plaintiffs allege makes this action necessary.

It was not until May 17, 1962 that defendants deposited $2,206,000 in the Superior Court and, on the same day, the Superior Court entered the final order of condemnation which the court below held was collaterally attacked by this action. However, the undisputed facts show that prior to entry of this final order the California Superior Court never considered plaintiffs' contentions herein, nor could it have. The

order of condemnation of the Superior Court was entered on May 17, 1962, the very same day the $2,206,000 was deposited with the Superior Court, and such order was annexed *ex parte* (Par. 49 of Complaint; admitted in Par. 25 of Answer). The immediate entry of such order *ex parte*—that is, without notice to any adverse party and without a hearing—means that no party had the opportunity to bring the facts which are the basis of plaintiffs' contentions herein to the State Court's attention prior to entry of its final order. Nor do defendants contend that these issues were presented to the State Court thereafter.

The words of the final order simply state that "plaintiff has already paid into court for defendant the sum of Two Million Two Hundred Six Thousand Dollars ($2,206,000). . . ." The sole inference that can be drawn from these words, particularly in view of the procedural prerequisites and history hereinabove referred to, is that the Superior Court, when presented with the final order, viewed its function as solely to determine whether in fact $2,206,000 had been paid into the registry of the Court. When it did so determine, it entered the final order in accordance with Paragraph VIII of the Interlocutory Judgment quoted above as a mere ministerial act.

Thus the undisputed facts demonstrate that the contention that the sale of City's bonds to First Boston was improper was never presented to the Superior Court before its final order was entered. Nor has any contention been advanced herein that such an

argument was ever presented to the Superior Court thereafter. The only determination that the California court made was that $2,206,000 had, in fact been deposited, this being the sole determination it was bound to make under the terms of the Interlocutory Judgment.

On these facts the decided cases make it abundantly clear that the present action cannot be deemed a collateral attack on the state court judgment.

Allegheny County v. Mashuda Co., 360 U.S. 185 (1959) involved facts which were in many ways analogous to the instant situation. In that case, the United States Supreme Court forcefully overruled an argument to the effect that, because of alleged encroachment on a state's sovereign rights relating to eminent domain, a federal district court whose diversity jurisdiction had been properly invoked could refuse, pending the outcome of state court proceedings, to entertain a case seeking to bar the state condemnation action. The decision gave broad recognition (see particularly p. 190) to the power and duty of a federal district court to proceed with such a case notwithstanding that its effect would admittedly be to impinge on parallel, pending state court condemnation proceedings.

Other decisions similarly demonstrate that the attachment of *in rem* jurisdiction over property by the state courts will not bar the federal courts' exercise of a parallel, *in personam* jurisdiction even if the result would be an interference with the prior state court proceedings.

A recent example of such a case is *Banco Nacional de Cuba v. Sabbatino,* 193 F. Supp. 375 (S.D.N.Y. 1961), aff'd 307 F.2d 845 (2nd Cir. 1962). There, the agent for a Cuban bank sued a broker and a state court receiver in the United States District Court for conversion of certain monies. The receiver, appointed by the Supreme Court of the State of New York, had in his possession under court order, the proceeds of the sale for which plaintiff was suing. The order of the state court which had directed the turnover of the money in issue to the state court's receiver had provided that the proceeds were to be held "subject to the further order of the court and not to be withdrawn except on such order."

As in the instant case, the jurisdiction of the District Court was invoked on the basis of diversity as well as on the basis of the presence of a federal question. The Court of Appeals did not reach the question whether federal jurisdiction could have been grounded on the latter premise. It held that the diversity was established.

It was contended in *Banco Nacional* that the jurisdiction of the court was defective because the District Court lacked jurisdiction over the subject matter. The motion was based on the proposition that since the proceeds of the sale had been turned over to a New York state court and the state court had perfected its jurisdiction either *in rem* or *quasi in rem* over those proceeds before the District Court had perfected its jurisdiction over the parties, the District Court lacked jurisdiction over the subject matter. The Court of

Appeals conceded that it had been long established that the court which first obtained jurisdiction over a particular *res* is entitled to retain that jurisdiction to the exclusion of other courts. But the court concluded that the state court's possession of the fund in issue was no bar to the action. It held (at p. 852):

> "But if the action brought in the federal court is an *in personam* action that does not interfere with the state court's jurisdiction over the fund it holds, the federal court has jurisdiction to adjudicate the rights of the parties. *United States v. Bank of New York & Trust Co.,* 296 U.S. 463, 477, 56 S. Ct. 343, 80 L. Ed. 331 (1936); *Stanton v. Embrery,* 3 Otto 548, 93 U.S. 548, 23 L. Ed. 983 (1877). This is so even if the issues in the state court case and in the federal court case are identical.
>
> "For cases applying this rule where an in rem or quasi in rem action preceded an in personam one see *Markham v. Allen,* 326 U.S. 490, 66 S. Ct. 296, 99 L. Ed. 256 (1945) (state action followed by federal one); *United States v. Klein,* 303 U.S. 276, 58 S. Ct. 536, 82 L. Ed. 840 (1938) (federal action followed by state one); *Commonwealth Trust Co. v. Bradford,* 297 U.S. 613, 56 S. Ct. 600, 80 L. Ed. 920 (1936) (state action followed by federal one).
>
> "The plaintiff in the present case in an *in personam* action seeks a money judgment for damages against Farr, Whitlock for conversion. The fund in the hands of the New York state court need not be interfered with by a judgment for the plaintiff against Farr, Whitlock personally.

> Therefore, the state court's control of the sale proceeds has not preempted the jurisdiction of the federal court over the subject matter of the present litigation, and the court below was correct in holding that it had jurisdiction to decide the controversy between the parties."

Moreover, the principles set forth in the *Banco Nacional* case have been consistently applied in many other types of cases in which the federal courts have proceeded to give relief notwithstanding the existence of apparently conflicting state court proceedings. See, *e.g., Markham v. Allen,* 323 U.S. 490 (1946); *Commonwealth Trust Co. v. Bradford,* 297 U.S. 613 (1936); *Waterman v. Canal Louisiana Bank Co.,* 215 U.S. 33 (1909); *Byer v. McAuley,* 149 U.S. 608 (1893); *Clark v. Tibbets,* 167 F.2d 397 (2d Cir. 1948).

United States v. Klein, 303 U.S. 276 (1930)—a case involving a converse fact situation from that presented here—is nevertheless closely in point. There, a fund was in the registry of the federal court. A party claiming ownership of that fund sought to obtain an adjudication of his rights from the state court. On appeal to the Supreme Court, his right to such relief was upheld in the following language:

> "While a federal court which has taken possession of property in the exercise of the judicial power conferred upon it by the Constitution and laws of the United States is said to acquire exclusive jurisdiction, the jurisdiction is exclusive only insofar as restriction of power of other courts is necessary for the federal court's appro-

> priate control and disposition of the property. [Citations omitted.] Other courts having jurisdiction to adjudicate rights in the property do not, because the property is possessed by a federal court, lose power to render any judgment not in conflict with that court's authority to decide questions within its jurisdiction and to make effective such decisions by its control of the property. [Citations omitted.] *Similarly a federal court may make a like adjudication with respect to property in the possession of a state court.* [Citations omitted.]" (Emphasis supplied.)

Thus, the Supreme Court held in the *Klein* case that notwithstanding the fact that the *res* or fund was in the custody of the federal court, the state court had *in personam* jurisdiction to declare ownership rights in respect of the fund. The only distinction from our case is that the fund here is in the registry of the state court, while it is the federal court that is being asked to declare, *in personam,* certain findings with reference to claims that may exist in respect of such fund.

It should also be noted that the reasoning of the *Klein* case completely undercuts the distinction purportedly made by the District Court herein (Tr. 53) of the *Mashuda* case on the supposed ground that *Mashuda* did not involve a final judgment.

Innumerable other decisions deal with and refute the possibility that an action such as the instant one, which is premised on issues not determined in a prior

judgment, can be viewed as a collateral attack on such an earlier judgment. See, *e.g.*:

Pete v. Henderson, 124 Cal.App.2d 487, 269 P.2d 78 (1st Dist. 1954);

Williams v. Nylund, 268 F.2d 91 (10th Cir. 1959);

Hixson v. Cook, 279 P.2d 677 (Okl. S.C. 1963);

Stavros v. Bradley, 313 Ky. 676 (Ky. Ct. App. 1950);

Arenas v. United States, 95 F. Supp. 962 (S.D. Cal. 1951) aff'd 197 F.2d 418 (9th Cir. 1952);

Rocky Mountain Fuel Co. v. Heflin, 148 Colo. 415 (Col. S.C. 1961);

Commercial Securities Co. v. Thompson, 239 S.W.2d 911 (Tex. Ct. Civ. App. 1951);

Kluth v. Andrus, 101 N.E.2d 310 (Ohio Ct. App. 1951).

In the *Rocky Mountain Fuel Co.* case, *supra,* it was contended that a state court action to quiet title constituted a collateral attack upon an earlier federal court order affecting the same property, which had been issued in connection with a reorganization proceeding. The court rejected this contention, stating (at p. 420):

> "The Fuel Company argues that the trial court's decree was a collateral attack upon the United States District Court's order. With this contention, we do not agree. The order of the United States District Court was one confirming and approving the sale of trust property, an acceptance of the consideration paid and an order

implementing the completion of the transfer. *The United States Court had before it a question of liquidation of assets, payment of creditors and reorganization, not issues of the rule against perpetuities and the Colorado law of future interests.* See *Hildebrand v. Harrison* (Okla.) 288 P.2d 399. This action involves an interpretation of certain reservations in the Trustee's deed and does not involve an attack on a decree of the United States District Court. *St. Louis K. C. & C. Ry. Co. v. Wabash Ry.*, 217 U.S. 247, see *Koen v. Fort Bent Ditch Co.*, 67 Colo. 34, 184 Pac. 653; see also *Quintrall v. Goldsmith*, 134 Colo. 410, 306 P.2d 246." (Emphasis supplied.)

Similarly, in *Hixson v. Cook, supra,* a declaratory judgment was made adjudicating plaintiff's rights in property over the objection that some years earlier such property had been the subject of an apparently contrary judicial "homestead" judgment. The contention that the second proceeding amounted to a collateral attack on the earlier homestead determination was rejected by the appellate court which stated (at p. 684):

"We agree that the order setting aside the homestead property has become final, but we do not agree that plaintiff's petition amounts to a collateral attack upon it, or that the county court order must be vacated before the district court acquires jurisdiction in this case. The county court order setting apart the order amounts to a determination merely that (1) the homestead character attached to the land at the time of the death of the decedent and (2) that at the time of

making the order, the surviving spouse had not waived or abandoned the homestead. The effect of such an order is (1) to forever free the homestead property of claims for debts of the decedent, and expenses and charges of administration, and (2) to postpone or delay the right of the heirs to take possession of the property until the homestead character has ceased to exist.

"A collateral attack upon a judgment is an attempt to avoid, defeat or evade it, or deny its force and effect in some incidental proceedings not authorized by law for the express purpose of attacking it. *Continental Gin Co. v. De Bord,* 34 Okl. 66, 123 P.2d 59.

"Plaintiff's petition in this case, and the district court judgment entered thereon, is not an attempt to 'avoid, defeat or evade' the county court order, or to 'deny its force and effect.' The property concerned is *still* free of debts of the decedent, and expenses and charges of administration; and the right of the heirs to take possession of the property *has* been delayed. The county court order has therefore been given full force and effect.

"The issue tried in the district court [in this case] was whether, subsequent to the entering of the county court order, Mrs. Hixson had by her conduct, abandoned the homestead. Needless to say, *this* issue was not presented to, or tried by the county court [in the previous case]." (Emphasis added.)

Likewise, in *Kluth v. Andrus, supra,* it was held that an action for mandamus would lie to vacate a civil service appointment notwithstanding that such

appointment had previously been approved in earlier judicial proceedings. Rejecting the argument that the mandamus suit constituted a collateral attack on the prior judgment, the court stated (at p. 322):

> "We do not consider that the present action constitutes a collateral attack on the judgment of the trial court in the Patton case, and, from the evidence before us, that case was undoubtedly correctly decided on the basis of the pleadings and facts there presented. It does not, however, adjudicate the rights of plaintiff in this case, whom we find entitled to the injunction prayed for."

See also *Arenas v. United States, supra,* where the District Court rejected a similar contention that an action constituted a collateral attack on a prior judgment in the following language (at p. 971):

> "No binding judgment can be rendered against a person involving his personal status or rights,—such as legitimacy or heirship,—unless he is a party to the action, or is before the court through representation by others. Della, as Guadaloupe's heir at law, was not before the court. She is a stranger to the record. Her rights of heirship were not asserted in any pleading filed in the case and were not adjudicated by the court. She cannot be deprived of them by a negative finding that Arenas is the 'sole heir,' when neither she nor the United States Government representing her *as an heir,* was before the court to assert or defend her heirship rights. The complaint in the Arenas case did not challenge her heirship by any direct allegation."

Plaintiffs here similarly seek only a declaration of their *in personam* rights. As indicated by the many decisions hereinabove discussed, such a declaration is proper notwithstanding the existence of an *in rem* judgment involving the property at issue, even if such judgment has conflicting implications.

POINT III

THE DISTRICT COURT IMPROPERLY CONSTRUED THIS COURT'S DECISION IN THIBODO v. UNITED STATES AS BARRING PLAINTIFFS' RIGHT TO RELIEF UNDER THE SECOND COUNT OF THE COMPLAINT.

As their second count of the instant complaint, plaintiffs alleged that their security interest had been impaired by an unlawful taking in violation of the provisions of the California and United States constitutions which inhibit the taking of private property without due process of law. The District Court peremptorily dismissed this count of the Complaint, stating (Tr. 50):

> "As to such an issue the Court of Appeals for the Ninth Circuit has noted, in an eminent domain situation, that relief should first be sought from the state courts (Thibodo v. United States, 187 F.2d 249, 257)."

On its face, however, *Thibodo* is wholly inapplicable to the instant case because here the federal court's jurisdiction rests on diversity of citizenship under 28 U.S.C.A. § 1332, whereas in *Thibodo* the

court's jurisdiction rested solely on an unconstitutional deprivation of rights which allegedly created federal question jurisdiction under 28 U.S.C.A. § 1346(2). *Thibodo v. United States, supra*, at p. 251.

Compare *Allegheny County v. Mashuda*, 360 U.S. 185, in which the federal court's jurisdiction rested on diversity of citizenship, as it does here. There the Supreme Court stated (at p. 196):

> "The propriety of a federal adjudication in this case follows *a fortiori* from the established principle that Federal District Courts should apply settled state law without abstaining from the exercise of jurisdiction even though this course would require decision of difficult federal constitutional questions. *Chicago v. Atchison, T. & S.F. R. Co.*, 357 U.S. 77; *Public Utilities Comm'n of California v. United States*, 355 U.S. 534; *Toomer v. Witsell*, 334 U.S. 385."

Naturally, the fact that plaintiffs also have a remedy in the state court does not mean that they are disentitled to an otherwise available remedy from the federal court. As the court stated in *C. D. Mathews Estate v. Olive Branch Drainage*, 185 F.2d 53 (7th Cir. 1950) (also a diversity case) (at p. 54):

> "Certainly the mere fact that the appropriate remedy in the state court, had plaintiff chosen to bring its action there, would have been by mandamus, a mode of relief not available in the United States court as an independent proceeding, does not mean that plaintiff has no standing in the federal court."

The court below also indicated parenthetically that (Tr. 52) "the abstention doctrine is additional support for compelling the plaintiffs to seek state court relief as to Count 2." There are, however, no grounds in this case for the invocation of that doctrine. See generally *Allegheny County v. Mashuda Co.*, 360 U.S. 185, 189. There is no disruption here of the state administrative process, no necessity of postponement because of the possibility that a determination of state law will moot the issues herein, no injunction of state officials from executing domestic policies and, in short, no hazard of disrupting federal-state relationships. The only questions for decision in connection with this second count are factual issues, many the same as those raised by the first count. The Supreme Court in *Allegheny County v. Mashuda, supra*, has stated that a federal court may not refuse to exercise jurisdiction "in the absence of exceptional circumstances which clearly justify an abstention." No such circumstances have been alluded to by the District Court in the instant case, and, in fact, none are here present.

The additional reasons adduced by the District Court for dismissal of the second count of the Complaint are insufficient justification for its dismissal. Consequently, the second count should also be allowed to stand.

CONCLUSION

The judgment below dismissing the complaint for failure to state a claim upon which relief can be granted should be reversed.

Dated, Sacramento, California,
December 2, 1963.

Respectfully submitted,
WILKE, FLEURY & SAPUNOR,
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Attorneys for Appellants.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

WILKE, FLEURY & SAPUNOR,
By JOHN M. SAPUNOR,
Attorneys for Appellants.

No. 18,904

United States Court of Appeals

For the Ninth Circuit

Marine Midland Trust Company, etc., et al.,
Appellants,
vs.
City of North Sacramento, etc.,
Appellee.

City of North Sacramento, a municipal corporation,
Appellant,
vs.
Marine Midland Trust Company, etc., et al.,
Appellee.

On Appeal from the United States District Court for the Northern District of California, Northern Division

OPENING BRIEF OF APPELLANT CITY OF NORTH SACRAMENTO

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On Appeal from the United States District Court for the Northern District of California, Northern Division

OPENING BRIEF OF APPELLANT CITY OF NORTH SACRAMENTO

INTRODUCTION

The District Court granted the motion of the defendant City of North Sacramento (hereinafter "defendant City") to dismiss plaintiffs' action, but defendant City is appealing from that portion of the

Judgment which denies costs to the City. It is also appealing from an Order subsequently made by the District Court on May 22, 1963 (TR 81a) which denied defendant City's motion to amend the Judgment to include an award of costs, and for leave to file a counterclaim against plaintiffs for certain costs, damages and expenses resulting to defendant City from the bringing of the action. This Brief is defendant City's Opening Brief on its appeal from the "without costs" portion of the Judgment of Dismissal from the Order which denied its post-judgment motions.

JURISDICTION

Plaintiffs' complaint alleged diversity of citizenship (TR 1 and 2), but defendant City urged in the District Court that diversity was absent because plaintiffs had failed to join an indispensable party, to-wit, Citizens Utilities Company of California, a California corporation, whose interests would require its alignment with plaintiffs, thus putting California citizens on both sides of the litigation. Accordingly, defendant City sets forth no grounds here for jurisdiction in the District Court to support plaintiffs' action.

The District Court had jurisdiction however to grant the relief sought by defendant City. Jurisdiction to award to defendant City its costs is granted by 28 U.S.C. § 1919 and Rule 54(d) of the Federal Rules of Civil Procedure. It had diversity jurisdic-

tion to hear defendant City's counterclaim against the plaintiffs, as that did not involve any absent parties, and the procedural sanction therefor is contained in Rule 13(e) and 15(d) of the Federal Rules of Civil Procedure.

This Court of Appeals has jurisdiction to review the District Court's Judgment denying costs to defendant City and its denial of defendant City's motions to file a counterclaim and to amend the judgment re costs, under 28 U.S.C. 1291.

STATEMENT OF THE CASE

Plaintiffs brought this action in the District Court to set aside the defendant City's prior condemnation of a privately owned water system serving the City of North Sacramento and its inhabitants (Complaint, TR 1-25). The condemnation proceeding had been instituted by the defendant City on December 3, 1956 (TR 6, line 4), and Interlocutory Judgment of Condemnation was rendered by the Superior Court of the State of California, in and for the County of Sacramento, on November 5, 1959 (TR 6, lines 26-28). The parties to the State Court condemnation action were the defendant City (as plaintiff) and Citizens Utilities Company of California, a California corporation, the owner of the water system (as defendant).

The gist of the plaintiffs' action in the District Court was that payment of the condemnation award in the State Court by defendant City was void and

ineffective because the money used for payment was obtained from a bond sale which was alleged to be unlawful, improper and illegal (TR 20, par. No. 57) in several respects. The principal charge of the complaint was that the City delivered a no-litigation certificate to the bond purchaser during the period when the condemnee could still take an appeal to the United States Supreme Court on a question relating to increase in value of the water system during the period of the condemnation proceeding (TR 6-14).

Plaintiffs' alleged standing to complain of the legality of the defendant City's payment of the condemnation award was grounded upon the fact that, pursuant to an Indenture of Mortgage and Deed of Trust between it and the parent corporation of Citizens Utilities Company of California, the condemnee in the State Court proceeding, it had the right to receive awards paid for the condemnation of subsidiary-owned property.

The defendant City and the co-defendants, the Mayor, Treasurer and City Clerk, filed a motion to dismiss on several grounds, and this motion, after considerable briefing by both sides, was granted by the District Court on April 16, 1963 (TR 47-54). The formal Judgment of Dismissal was entered on April 25, 1963 (TR 57).

Within ten days after the entry of the formal Judgment of Dismissal, the defendant City made a motion to file a counterclaim under Rules 13(e) and 15(d), for recovery of its costs, damages and expenses

resulting from the bringing of the action, pursuant to Section 526b of the California Code of Civil Procedure; it also filed a companion motion to amend the Judgment to allow the City its costs under Rule 59(e). The co-defendant City officers did not join in these motions as all such costs, damages and expenses had been borne by the defendant City. Plaintiffs filed no points or authorities in opposition to either of defendant City's motions, and on the day set for hearing of the motions, the Court took them under submission without oral argument from either party. It then denied both motions on May 22, 1963.

The questions involved upon this appeal taken by the defendant City are as follows:

a. Whether the District Court erred in denying defendant City's motion to file a counterclaim to permit recovery under C.C.P. 526b; and

b. Whether the District Court committed an abuse of discretion in denying the defendant City its costs.

SPECIFICATION OF ERRORS RELIED UPON

1. The District Court abused its discretion in denying defendant City's motion to file a counterclaim to recover, under C.C.P. 526b, the costs, damages and expenses resulting to it from the bringing of the action by plaintiffs.

2. The District Court abused its discretion in not awarding the defendant City its costs as "the prevailing party" under Rule 54(d).

ARGUMENT OF THE CASE

1. THE DISTRICT COURT ABUSED ITS DISCRETION IN DENYING DEFENDANT CITY'S MOTION TO FILE A COUNTERCLAIM TO RECOVER THE COSTS, DAMAGES AND EXPENSES RESULTING TO IT FROM THE BRINGING OF THE ACTION BY PLAINTIFFS, BECAUSE THIS WAS A DIVERSITY CASE AND SUCH A RECOVERY WAS CLEARLY SANCTIONED BY CALIFORNIA LAW (C.C.P. 526b), THE CLAIM COULD BEST BE DETERMINED AND ALLOWED BY THIS COURT WHICH WAS FAMILIAR WITH THE CASE AND HAD JURISDICTION OVER THE PLAINTIFFS, AND THE PLAINTIFFS MADE NO FORMAL OPPOSITION TO THE FILING OF THE COUNTERCLAIM.

Section 526b of the California Code of Civil Procedure provides as follows:

> "Every person or corporation bringing, instigating, exciting or abetting, any suit to obtain an injunction, restraining or enjoining the issuance, sale, offering for sale, or delivery, of bonds, or other securities, or the expenditure of the proceeds of the sale of such bonds or other securities, of any city, city and county, town, county, or other district organized under the laws of this State, or any other political subdivision of this State, proposed to be issued, sold, offered for sale or delivered by such city, city and county, town, county, district or other political subdivision, for the purpose of acquiring, constructing, completing, improving or extending water works, electric works, gas works or other public utility works or property, shall, if the injunction sought is finally denied, and if such person or corporation owns, controls, or is operating or interested in, a public utility business of the same nature as that for which such bonds or other securities are proposed to be issued, sold, offered

> for sale, or delivered, be liable to the defendant for all costs, damages and necessary expenses resulting to such defendant by reason of the filing of such suit."

A brief analysis will show that this statute was applicable to the action brought by these plaintiffs, and that upon its dismissal by the District Court, defendant City was entitled to recover from the plaintiffs all of the costs, damages and necessary expenses resulting to it by reason of the filing of such suit.

The gist of plaintiffs' complaint was that the defendant City was "guilty of unlawfully, inproperly and illegally issuing and selling its Water Revenue Bonds" (TR 20, par. No. 57), and the plaintiffs sought judgment

> "Declaring, adjudging and decreeing . . . that the deposit in the sum of $2,206,000 made by defendants, with the Clerk of the Superior Court, in and for the County of Sacramento, is . . . disqualified to serve as an effective payment and as a predicate for a transfer of title and possession of the said water system to defendant City;" (TR 23, par. 1(a) of prayer).

The action, while not in form seeking to enjoin the expenditure of the bond proceeds for the acquisition of the water system, sought to reach the same end by asking for a declaratory judgment nullifying the City's payment for the water system. Such a judgment would of course fully prevent the City from paying for the water system with the bond proceeds. In result, effect and substance, the action sought to

restrain or enjoin the expenditure of the proceeds of the City's bonds for the purpose of acquiring the water works or system.

The judgment dismissing the action operated as a final denial of the "injunction sought". Finally, the plaintiffs are persons who own, control, operate or are interested in a public utility business of the same nature as the water works being acquired by defendant City. The complaint alleges that Citizens Utilities Company, parent corporation of Citizens Utilities Company of California, was engaged directly and indirectly through subsidiary corporations, in the ownership and operation of various public utility systems in ten of the states of the United States (TR 3, lines 2-4), and that Citizens Utilities Company had pledged all of its issued and outstanding stock with the plaintiffs as collateral security for bonds issued by Citizens (TR 3, line 32, and TR 4, lines 1 and 2). As the City pointed out to the District Court in seeking to file its counterclaim, Citizens had additionally conveyed via the Indenture of Mortgage and Deed of Trust to plaintiffs (TR 3, par. No. 12), several other water systems owned by it in California and other states as security for its loans.

Thus the defendant City, in making its companion motions to amend the judgment and for leave to file a counterclaim, was invoking an absolute substantive right of recovery given to it by State law. C.C.P. 526b entitled it to recovery of its attorney's fees, *S.M.U.D. v. P.G.&E.*, 20 C.2d 684, which are not normally recoverable under California law (C.C.P.

1021), all costs necessarily incurred in the litigation, plus any damages resulting from the filing of the suit. These are substantial rights, giving the City a right of recovery which goes way beyond that which the State normally affords to successful litigants.

There is a clear, unmistakable policy of the State of California embodied in the statute. As a practical matter, cities and public agencies can finance the acquisition and development of utilities to serve their inhabitants only through the sale of long-term bonds. Section 526b is obviously designed to inhibit adverse interests from rupturing this financing ability by groundless attacks on the sale of the bonds. Even though utility-inspired litigation attacking the bonds or their sale may ultimately be unsuccessful, serious harm to the City results. Investors either become unwilling to purchase the City's bonds or are willing to do so only at a discount and at burdensome interest rates.

> "It (the private utility) would be especially tempted to prosecute such litigation, and the Legislature in order to protect the public agency in engaging in a pursuit which it deemed necessary to the public welfare, might reasonably have required, as it did, that a private utility with such a probable motive should reimburse the public treasuries for expenses incurred in unjustifiable litigation prosecuted by the utility." *Sacramento M.U.D. v. P.G.&E. Co.*, 20 C.2d 684, 694.

This is a diversity case. Plaintiffs based the jurisdiction of the federal Court upon their allegations

that they were citizens of New York and Connecticut respectively, that defendants were citizens of California, and that the matter in controversy exceeded $10,000 (TR 1 and 2, par. 1-7 of complaint). The District Court exercised its diversity jurisdiction and disposed of the case as a California Court (TR 53).

Particularly in view of the clear State policy underlying C.C.P. 526b, the District Court should have, following the dismissal of plaintiffs' action, permitted defendant City to file its counterclaim for its costs, damages and expenses, and it should also have granted the City's motion to amend the judgment to award the defendant City its "costs". This absolute and substantive right of recovery must be given effect by the federal Court in a diversity case under the Rules of Decision Act, now contained in 28 U.S.C. 1652:

> "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply."

The federal Court cannot pick and choose from among state laws in a diversity case; it must take and apply the state law as it finds it.

> "In essence, the intent of that decision (Erie R. Co. v. Tompkins) was to insure that, in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the outcome of the litigation in the federal court should be substantially the same,

> so far as legal rules determine the outcome of a litigation, as it would be if tried in a State court. The nub of the policy that underlies Erie R. Co. v. Tompkins is that for the same transaction the accident of a suit by a non-resident litigant in a federal court a block away should not lead to a substantially different result." *Guaranty Trust Co. v. York,* 326 U.S. 99, at 109, 89 L.ed. 2079, at 2086.

Again and again the United States Supreme Court has made it clear that the federal Courts must accept and apply state statutes in diversity cases. Addressing itself particularly to a Nebraska attorneys fee statute in *Sioux County v. National Surety Co.* (1928), 276 U.S. 238, 72 L.ed. 547, the Court said:

> "Disregarding mere matters of form it is clear that it is the policy of the state to allow plaintiffs to recover an attorney's fee in certain cases, and it has made that policy effective by making the allowance of the fee mandatory on its courts in those cases. It would be at least anomalous if this policy could be thwarted and the right so plainly given destroyed by removal of the cause to the federal courts." (276 U.S., at 243).

The Supreme Court reached the same conclusion on an attorney's fee statute and directed that it be applied in the diversity action entitled *Cohen v. Beneficial Industrial Loan Corp.* (1948), 337 U.S. 541, 93 L.ed. 1528, 69 S.Ct. 1221.

It is plain that the District Court has discretion in permitting the filing of a counterclaim under Rule 13(e) of the Federal Rules of Civil Procedure. How-

ever, every factor present favored the filing of the counterclaim. The defendant City had an absolute right to the recovery sought under State law. The District Court was familiar with plaintiffs' suit and the efforts required of defendant City to defend against it. Plaintiffs being citizens of New York and Connecticut respectively (TR 1), the District Court's denial compels defendant City to seek its recovery under C.C.P. 526b against these plaintiffs at their domicile in New York and/or Connecticut, which may in practical effect defeat its recovery entirely. There is a good possibility that those jurisdictions would not permit recovery under the California statute, particularly if such a cause of action did not exist in their jurisdiction.

> "The purpose of Rule 13(e) is to provide a means for complete litigation in one action of all claims that parties may have with respect to each other and thus avoid a multiplicity of actions. 3 Moore's Federal Practice (1948) 2 Ed., Para. 1332, p. 85 et seq." *Cold Metal Products Co. v. Crucible Steel Co.* (D. N.J. 1954), 126 F. Supp. 546.

See also *Kerotest Mfg. Co. v. C-O-Two Co.*, 342 U.S. 180, 96 L.ed. 200, 72 S.Ct. 219, sanctioning "conservation of judicial resources and comprehensive disposition of litigation", and affirming the decision of the Court of Appeals for the Third Circuit which declared:

> "Why should there be two litigations where one will suffice? We can find no adequate reason." (page 183)

Finally, the plaintiffs filed no reasons or authorities in opposition to defendant City's motion as required by Rule 12(b) of the Rules of Practice for the District Court, nor made an oral argument in opposition to it. In view of all of these circumstances, it was a clear abuse of discretion for the District Court to deny defendant City leave to file its counterclaim.

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2. THE DISTRICT COURT ABUSED ITS DISCRETION IN NOT ALLOWING DEFENDANT CITY ITS COSTS UNDER F.R.C.P. RULE NO. 54(d), INSOFAR AS DEFENDANT CITY WAS CLEARLY THE PREVAILING PARTY AND NO REASON WAS PRESENT FOR MAKING IT PAY ITS OWN COSTS. IN ADDITION, C.C.P. 526b AND THE ABSENCE OF FORMAL OPPOSITION TO THE CITY'S MOTION RE COSTS MADE THEIR ALLOWANCE TO DEFENDANT CITY MANDATORY.

Quite aside from defendant City's rights under C.C.P. 526b, it should have been awarded its costs under the Federal Rules of Civil Procedure. The meaning of Rule 54(d) relative to awarding of costs is clear.

> "Except when express provision therefor is made either in a statute of the United States or in these rules, costs shall be allowed as of course to the prevailing party unless the court otherwise directs. . . ."

In this case defendant City was clearly the prevailing party. There is no federal statute or Rule on costs specially applicable. Costs should therefore have been awarded to defendant City. Admittedly the District Court may, in its discretion, deny costs to the prevailing party, but there must be *some reason* for doing so. None was present in this case. The Court's

Memorandum and Order (TR 47) concludes that the motion to dismiss the action should be granted, but gives no reason why defendant City should bear its own costs. The formal Judgment of Dismissal "without costs" (TR 57) gives no reason. The Order made on May 22, 1963 (TR 81a) denying defendant's motions relative to costs gives no reason. There was in fact no reason present.

The District Court's discretion to deny costs to the prevailing party cannot mean that it may grant or deny them however it is so inclined. Reason must be present for denying them to the prevailing party. The underlying principle was well stated in *Chicago Sugar Co. v. American Sugar Co.* (7th Cir. 1949), 176 F.2d 1, at page 11:

> ". . . the denial of costs to the prevailing party or the assessment of partial costs against him is in the nature of a penalty for some defection on his part in the course of the litigation as, for example, by calling unnecessary witnesses, bringing in unnecessary issues or otherwise encumbering the record, or by delaying in raising objection fatal to the plaintiff's case. . . . in the absence of some showing of bad faith or the deliberate adoption of a course of business dealings calculated to render litigation pertaining thereto unnecessarily prolix and expensive, the penalty of denial or apportionment of costs under Rule 54(d) should be imposed only for acts or omissions on the part of the prevailing party in the actual course of the litigation, except that where it is clear that the action was brought in good faith, involving issues as to which the law

> is in doubt, the court may in its discretion require each party to bear its own costs although the decision is adverse to plaintiff.''

In view of the foregoing, in view of the California policy outlined in C.C.P. 526b, and in view of the plaintiffs' failure to file or present any reasons or authorities in opposition to defendant City's motion to amend the Judgment relative to costs, it was clearly an abuse of discretion for the District Court to deny this motion also.

Wherefore, defendant City prays that this Honorable Court order the District Court to amend its Judgment of Dismissal made and entered on April 26, 1963, by striking therefrom "without costs", and inserting in lieu thereof the following: "all costs in this proceeding to be taxed upon the plaintiffs"; and further, to make its order permitting defendant City to file its counterclaim against the plaintiffs, in substantially the form attached to its motion therefor dated May 6, 1963.

Dated, December 4, 1963.

Respectfully submitted,

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Certificate of Counsel

I certify that, in connection with the preparation of this Brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.

Daniel F. Gallery

No. 18,904

United States Court of Appeals

For the Ninth Circuit

MARINE MIDLAND TRUST COMPANY, etc., et al.,
Appellants,

vs.

CITY OF NORTH SACRAMENTO, et al.,
Appellees.

On Appeal from the United States District Court for the Northern District of California, Northern Division

BRIEF OF APPELLEES

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No. 18,904

United States Court of Appeals

For the Ninth Circuit

MARINE MIDLAND TRUST COMPANY, etc., et al., *Appellants,* vs. CITY OF NORTH SACRAMENTO, et al., *Appellees.*	

On Appeal from the United States District Court for the Northern District of California, Northern Division

BRIEF OF APPELLEES

This Brief of the City of North Sacramento, its Mayor, Treasurer and Clerk, is in reply to the Brief of Appellants Marine Midland Trust Company and John R. McGinley, who are appealing from the Judgment of the United States District Court for the Northern District of California, Northern Division, (Halbert, J.), dismissing their complaint.

JURISDICTION

The District Court had no jurisdiction of the action. The action was brought in the District Court on the ground that plaintiffs were citizens of New York and

Connecticut respectively, and that defendant City of North Sacramento and its co-defendant officers were citizens of California. But as will be demonstrated in this Brief, plaintiffs omitted to join an indispensable party, to wit., Citizens Utilities Company of California, a California corporation, which would be on the side of the plaintiffs if present, hence there was no diversity and no jurisdiction in the District Court.

STATEMENT OF THE CASE

In their "Brief of Appellants", plaintiffs excerpt certain portions of the complaint as a statement of the case, but these excerpts present such a fragmentary picture of the background to this litigation that it is necessary to make a more coherent outline of the chain of events leading up to the complaint, to permit a proper understanding of the issues and contentions on this appeal.

The transactions out of which this case arose began in 1956 when the inhabitants of the City of North Sacramento[1] (hereinafter called the "City") authorized, at an election, the acquisition of the privately owned water system supplying the inhabitants of the City and adjacent areas (Tr. 5).

The system was owned by Citizens Utilities Company of California (hereinafter referred to as "Cit-

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[1]The City of North Sacramento contains approximately 5.5 square miles and its 1960 population was 12,922 persons. It is located in Sacramento County, California, just across the American River from Sacramento, the State Capitol.

izens of California"), a corporation, incorporated, headquartered and doing business in California (Tr. 3). Negotiations for the purchase of the system were unsuccessful, and the City instituted proceedings in 1956 against the owner to acquire the system by condemnation (Tr. 6). The proceedings determining just compensation and whether the City had a right to condemn the water system lasted for nearly three years, and in 1959, the Sacramento County Superior Court rendered its Interlocutory Judgment of Condemnation in favor of the City, determining that the City had the right and power to condemn the system and that title thereto would vest in the City upon its payment of just compensation, found to be $2,206,000 as of December, 1956 (Tr. 6).

Citizens of California appealed the Interlocutory Judgment on several grounds, but without success. The California District Court of Appeal affirmed the Judgment in May, 1961,[2] and the California Supreme Court denied review on July 19, 1961 (Tr. 7).

The City then undertook to sell its previously authorized revenue bonds so that it might pay the just compensation required within the twelve month period allowed by C.C.P. 1251 (Tr. 8). In March, 1962, Citizens of California sought a stay of execution of the Interlocutory Judgment of Condemnation on the ground that the proceeds from the City's authorized revenue bond issue of $2,500,000 would not be sufficient to pay both the just compensation award and

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[2]*City of North Sacramento v. Citizens Utilities Co.* (1961), 192 Cal. App. 2d 482 (Tr. 7).

claimed increases to the value of the system since 1956 (Tr. 8 and 9).[3] The California Superior Court refused to grant such a stay (Tr. 9), and another series of appeals was taken by Citizens of California. The California District Court of Appeal refused to issue a writ of review and/or prohibition on April 18, 1962 (Tr. 9), the California Supreme Court denied a hearing on May 16, 1962 (Tr. 11), and the United States Supreme Court dismissed Citizens' appeal from these rulings on November 5, 1962, *Citizens Utilities Co. v. Superior Ct.*, 371 U.S. 67, 9 L.ed. 2d 119.

The City did sell its revenue bonds in May, 1962 (Tr. 13), and deposited the sum of $2,206,000 with the Clerk of the Superior Court, whereupon that Court made and entered its Final Order of Condemnation on May 17, 1962, declaring the City to be the owner of the system (Tr. 18). Citizens of California then took a third series of appeals, this time challenging the Final Order of Condemnation, but these too were unsuccessful (*City of North Sacramento v. Citizens Utilities Co.* (1963), 218 A.C.A. 193, petition for hearing denied by the California Supreme Court on September 4, 1963). All possibility of further appeal on the Final Order was lost in late 1963 and the condemnation action is no longer pending in the State Courts.

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[3]The owner of the utility is entitled to compensation for additions and betterments to the system made during the pendency of the condemnation proceeding; they are determined in a supplemental proceeding before the Public Utilities Commission (Pub. Utilities Code Sections 1416-1419).

Plaintiffs, who were not parties to the long and bitter litigation in the State Courts, filed this action in the United States District Court against the City, its Mayor, Treasurer, and Clerk, in August, 1962, to set aside the condemnation judgment, contending that the defendants had made certain fraudulent misrepresentations in effecting the sale of the City's Water Revenue Bonds, and that the proceeds thereof were therefore recoverable by the bondholders and could not be used or deposited into Court as an effectual payment of the just compensation award. Notwithstanding the fact that neither Citizens of California nor any of the City's bondholders were made a party to the action, plaintiffs sought an adjudication that the bonds were improperly and illegally sold, and prayed for judgment: (1) that the deposit of the $2,206,000 was not an effective payment to support the transfer of title and possession of the water system to the City (Tr. 23), (2) that the City holds the water system as trustee ex maleficio (Tr. 24), and (3) that the conveyance of the water system is null and void, and that it be returned to Citizens of California (Tr. 24).

Plaintiffs' claimed standing to challenge the bond sale and payment of the award is as assignees of the sole stockholder of Citizens of California, which is Citizens Utilities Company, a Delaware corporation (herein called "Citizens of Delaware") (Par. 9 and 10 of Complaint, Tr. 2). Citizens of Delaware had executed an Indenture of Mortgage and Deed of Trust in favor of the plaintiffs, pledging with plaintiffs all

its stock in Citizens of California to secure bonds issued by Citizens of Delaware (Par. 13 of Complaint, Tr. 3 and 4). In reinforcement of the pledge of stock, the Indenture further provided that plaintiffs would have the right to receive the proceeds from the condemnation of any property owned by Citizens of California.[4]

Plaintiffs state at the opening of their Brief that the allegations of the Complaint must be accepted as fact, particularly here because the District Court had denied defendant City's motion for summary judgment before granting its motion to dismiss the Complaint (Brief, p. 2). From the same denial, the plaintiffs also draw the conclusion that the District Court held that the facts, if established, would entitle the plaintiffs to relief (Brief, pp. 8 and 9).

Neither of these assertions will stand. This Court is not required to accept as true allegations which are erroneous interpretations of the law. Plaintiffs charge that defendant City made certain misrepresentations to the purchaser of its revenue bonds in failing to disclose "that California law required a con-

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[4]Paragraph 13 of the Complaint alleged that plaintiffs, in addition to being pledgees of the stock, had a direct security interest in the water system itself, and intimated that Citizens of California had assigned to plaintiffs their rights to the award. They clarified this in the District Court however, disclaiming any direct security interest in the water system and stating that their right to receive the condemnation award was based upon their agreement, not with Citizens of California, but with its sole shareholder (pp. 53 and 54, Plaintiffs' Memorandum in Opposition to Motion for Summary Judgment). It is clear that plaintiffs have no interest in the property of Citizens of California, and no agreement exists between them.

demnor to pay interest on the amount of the condemnation award from the date of Interlocutory Judgment until the taking of possession, which in this case aggregated over $350,000" (Brief, p. 4). It was expressly held that the City was *not required* to pay such interest in the condemnation proceeding to which plaintiffs refer by the California District Court of Appeal some six months before plaintiffs wrote their Brief (*City of North Sacramento v. Citizens Utilities,* 218 A.C.A. 193).

Plaintiffs further charge misrepresentation in the City's nondisclosure of pending annexation proceedings "which posed a threat to the financial integrity of the bonds" (Brief, page 4), whereas it is legally impossible that annexation of territory outside defendant City to another City, which is forever a possibility, would affect the bonds.

Another charge of misrepresentation was that City delivered a "false" no-litigation certificate to the bond purchaser (Brief, page 5). This so-called fraud boils down to a charge that the City certified that no litigation was pending which would affect the validity of its bonds, at a time when Citizens of California still had the right to appeal to the United States Supreme Court on its contention that the City could not take possession of the water system without posting security for any supplemental award that might be payable (Tr. 12 and 13). Of course the possibility of appeal in that case did not and could not affect the validity of the City's bonds, and the United States Supreme Court dismissed the attempted appeal on this

question "for want of a substantial federal question." *Citizens Utilities Co. v. Superior Court* (1962), 371 U.S. 67, 9 L.ed. 119.

The District Court, in denying City's motion for summary judgment, only noted that material issues of fact existed (Tr. 39 and 40) without specifying any particular issues, and that ruling cannot be used to fortify the many baseless charges upon which plaintiffs rest their complaint.[5]

ARGUMENT OF THE CASE

1. THE DISTRICT COURT PROPERLY RULED THAT THIS ACTION CONSTITUTED A COLLATERAL ATTACK ON THE STATE COURT CONDEMNATION JUDGMENT.

The District Court properly dismissed the action as it constituted a collateral attack on the condemnation judgment rendered by the California Superior Court, and such an attack is not maintainable except upon the ground of want of jurisdiction, extrinsic fraud or collusion, and none of these were alleged in plaintiffs' action.

As the District Court recognized in its Opinion (Tr. 52 and 53), the Final Order of Condemnation of the California Superior Court found and determined

> "that plaintiff (City) has already paid into court for defendant (Citizens of California) the sum

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[5]Under Rule 56(c) of the Federal Rules of Civil Procedure, the presence of material issues of fact precludes a summary judgment; its denial is not equivalent to a ruling that the complaint states a cause of action.

> of Two Million Two Hundred Six Thousand Dollars ($2,206,000) as the just compensation fixed in the Interlocutory Judgement,"

and that based upon said payment,

> "It Is Ordered, Adjudged and Decreed:
>
> I
>
> "That said condemnation and taking provided for in said Interlocutory Judgment of Condemnation in said proceeding is complete and final; plaintiff (City) fully has and owns the lands, properties and rights sought in said proceeding . . ." (Exhibit D to Answer).

The complaint in this action sought specifically an adjudication that

> "the deposit in the sum of $2,206,000 . . . is disqualified to serve as an effective payment and as a predicate for a transfer of title and possession of the said water system to defendant City"
>
> (and)
>
> "that the purported conveyance of the water system of Citizens of California was null and void, and that there be a return of the water system of Citizens of California by defendants . . ." (Tr. 23 and 24).

Thus this action was, as the District Court held, a clear and unquestioned attempt to overturn the determinations and judgment made by the State Court, but no grounds for sustaining such a collateral attack were shown.

> "The general rule applicable to a judgment rendered by a court having jurisdiction of the par-

> ties and subject matter is that unless reversed or annulled it is not open to contradiction or impeachment with respect to its validity or binding effect by parties or privies in any collateral proceedings. . . . A void judgment, however, may be collaterally attacked either by the parties or by strangers. . . . With respect to parties or privies such an attack is ordinarily limited to cases where the judgment is void on its face. . . . A stranger, however, whose rights would be prejudiced by its enforcement is not bounded by this limitation, but may attack a judgment for fraud or collusion. . . . But neither the parties, their privies nor strangers can attack a judgment of a domestic court of record . . . on account of mere errors or irregularities." *Assoc. Oil v. Mullin* (1930), 110 Cal. App. 385, 389.

Thus, even if the plaintiffs were strangers to the condemnation judgment they could not attack it for mere error or irregularity. They are however in privity with the condemnee in the State Court proceedings,[6] hence bound by the judgment unless they could show that it was void on its face, which they did not attempt to do.

The central theme of plaintiffs' appeal from the dismissal of their action (Point II of their Opening Brief) is that the collateral attack rule was improperly applied in that the questions raised by their complaint were not in fact raised or considered by

[6]They obtained their rights from and stand in the shoes of the stockholder of the corporation, who of course is bound by judgments against the corporation (*Gagnon Co., Inc. v. Nevada Desert Inn* (1955), 45 Cal. 2d 448, at 453; *Bank of America v. McLaughlin* (1937), 22 Cal. App. 2d 411 at 414).

the California Superior Court in making its Final Order of Condemnation.

But the bar to plaintiffs' action is not so narrow. The State Court judgment is final not only as to all questions which were actually raised by the parties, but as to all questions and contentions which could have been raised.

> " 'The judgment or decree of a court of competent jurisdiction upon the merits concludes the parties and their privies to the litigation, and constitutes a bar to a new action or suit involving the same cause of action, either before the same or any other tribunal;'
>
> "The principle goes even farther. 'The rule is often stated in general terms that a judgment is conclusive not only upon the questions actually decided and determined, but upon all matters which might have been litigated and decided in that suit.' " *Bank of America, etc. v. McLaughlin* (1937), 22 Cal. App. 2d 411, at 414 and 415.
>
> "It is the rule, long recognized in this country, that a judgment between the same parties is conclusive, not only as to the subject-matter in controversy in the action upon which it is based, but also in all other actions involving the same question, and upon all matters involved in the issues which might have been litigated and decided in the case, the presumption being that all such issues were met and decided." *Bingham v. Kearney* (1902), 136 Cal. 175, 177.
>
> "An adjudication is final and conclusive not only as to the matter actually determined, but as to every other matter which the parties might have litigated and have had decided as incident to, or

> essentially connected with, the subject-matter of the litigation, and every matter coming within the legitimate purview of the original action, both in respect to matters of claim and of defense. (citing cases)" *Estate of Bell* (1908), 153 Cal. 331, 340.

Citizens of California did not raise the contentions respecting the validity of payment that plaintiffs have raised in the federal action, but it could have; it did move to stay the Final Order on other grounds, and it did appeal the Final Order on other grounds, unsuccessfully (*City of North Sacramento v. Citizens Utilities Co.* (1963), 218 A.C.A. 193, hearing by Supreme Court denied). No contention was made that the $2,206,000 was "tainted", or otherwise an ineffective payment, but Citizens of California could have come before the California Court by motion or otherwise and obtained a determination on those contentions (C.C.P. § 937, 1252); however, it did not do so. The plaintiffs, who obtained their rights from the sole stockholder of Citizens and who are therefor in privity with Citizens of California, cannot do so either, now that the Final Order of Condemnation has become final.

> "a judgment on the merits against the corporation on the wrong alleged to have been done to it would ordinarily be res judicata in an action by the shareholders on behalf of the corporation for the same wrong." *Gagnon Co., Inc. v. Nevada Desert Inn, Inc.* (1955), 45 C. 2d 448, 453.

The decisions cited by plaintiffs on pages 24-32 of their brief differ from the instant case in many im-

portant respects. *Banco Nacional de Cuba v. Sabbatino* (S.D.N.Y. 1961), 193 F. Supp. 375, aff'd 307 F. 2d 845, cited by plaintiffs, involves federal v. state jurisdiction when the two Courts have the same action or controversy before them simultaneously and before either have proceeded to final judgment. If neither Court has yet rendered a judgment, there is of course no bar of collateral estoppel or res judicata to be raised. The only question is whether one action may proceed when the other Court has custody or control of the res or subject matter of the litigation.

> "But the mere adjudication by a federal court of a particular issue identical with an issue involved in *pending* litigation in a state court has never been considered so irritable to state prerogatives as to constitute a ground for federal abstention . . ." (emphasis added), *Banco v. Sabbatino,* 307 F. 2d at 854.

Moreover, unlike the case here, there was no privity or other relationship between the party claiming the property in the State Court action and the party claiming the property in the Federal Court action. *Banco* is hardly applicable to a case where the State Court has already rendered a judgment, binding against those with whom the federal action claimaint is in privity.

Markham v. Allen (1946), 326 U.S. 490, 90 L.ed. 256, was similar, in that there was no existing State Court judgment to which the Federal Court plaintiff (or his predecessors) had been a party. A probate proceeding was pending in the State Court, and Mark-

ham, a stranger thereto and claiming the property against the State Court claimants, brought them into the Federal Court and obtained a determination inter se as to his rights in the property. The federal judgment would conflict in no way with what the State Court was doing or had done.

> "The effect of the judgment was to leave undisturbed the orderly administration of decedent's estate in the state probate court . . ." (326 U.S. at 495)

In *Commonwealth Trust Co. v. Bradford* (1935), 297 U.S. 613, 80 L.ed. 920, there was no prior determination of rights binding the plaintiff in the federal action and it sought a determination of its rights in funds under the control of a pending State Court receivership proceeding. There was no final judgment out of the State Court and no question of res judicata or collateral estoppel raised. Likewise in *Waterman v. Canal Louisiana Bank Co.* (1909), 215 U.S. 33, 54 L.ed. 80, and *Byers v. McAuley* (1893), 149 U.S. 608, 37 L.ed. 867, the Supreme Court recognized the propriety of bringing an executor or administrator appointed in a *pending* State Court probate proceeding into the Federal Court for a determination of rights in the property of the estate in advance of the State Court making a determination thereof.

United States v. Klein (1930), 303 U.S. 276, 82 L.ed. 840, involved a state judgment respecting the ownership of unclaimed funds in the Federal Court, and the latter had made no determination respecting such ownership but was merely holding the funds for

whosoever might establish right thereto—there was neither an existing proceeding for such a determination pending in nor a judgment rendered by the Federal Court which would have been inconsistent with the adjudication in the State court.

Nor do the cases cited on page 29 of the plaintiffs' Brief support their appeal. None of those cases involved a collateral attack on an earlier judgment, and the decisions expressly pointed that out. In *Pete v. Henderson* (1954), 124 Cal. App. 2d 487, the action was by a party to the earlier judgment against his attorney for wrongfully permitting the earlier judgment to become final and immune to attack, the attorney having negligently failed to file a Notice of Appeal. The Court expressly recognized the integrity of the earlier judgment as between the parties that were bound thereby, but held that the action before it, involving different litigants, would not disturb the earlier judgment. In *Arenas v. U. S.* (9th Cir. 1952), 197 Fed. 2d 418, it was held that no collateral attack could be involved where the plaintiff in the second action was neither a party to nor in privity with any party to the first action and judgment, in which case she was not bound by any determination made in the first action. Simiarily in *Kluth v. Andrus* (1951), 101 N.E. 2d 310, the Court rejected the defendants claim of "collateral attack" in the second suit for the reason the that the plaintiff Kluth

> "was not a party and Kluth's status could not be affected by a case in which he was not made a party nor given opportunity to be heard. The

findings of the trial court in the Patton case could not be res judicata as to Kluth or others not parties to that action. This principle appears to us so fundamental and so thoroughly recognized that we merely cite the following authorities . . ." 101 N.E. 2d at 314.

Other cases cited by the plaintiffs are inapplicable because the second action sought a determination of rights resulting from the happening of events subsequent to the rendition of the first judgment. The Court in *Commercial Securities v. Thompson* (1951), 239 S.W. 2d 911, swept aside the argument of collateral attack on this ground, saying at page 914:

> "We overrule appellant's contention, made under its first point of error, that the Wichita County suit is a collateral attack on the Harris County judgment. The integrity of the court's action in Harris County is not questioned in the present suit, nor is there an effort here to change said judgment in any way."

The action in *Hixon v. Cook* (1963), 379 Pac. 2d 677, sought to set aside the previously adjudicated homestead on the ground of later abandonment of the homestead and the Court, addressing itself to the collateral attack argument said:

> "Plaintiffs' petition in this case, and the district court judgment entered thereon, is not an attempt to 'avoid, defeat or evade' the county court order, or to 'deny its force and effect.' . . . The county court order has therefor been given full force and effect." 379 Pac. 2d at 684.

Other of the cases cited by plaintiffs involve only actions to construct or interpret a prior judgment. The Court in *Williams v. Nylund* (10th Cir. 1959), 268 Fed. 2d 91, said this with respect to the second action:

> "But appellants do not question the effectiveness of the Oklahoma decree through the instant action. They seek, rather, a construction of that judgment in connection with the purported exercise of power under it by appellee as trustee. They do not ask the federal court to defeat the probate court decree, but to interpret it . . . The interpretation of a judgment involves no challenge to its validity." (268 F. 2d at 94).

Interpretation, not collateral attack, was also involved in *Stavros v. Bradley* (1950), 313 Ky. 676, 232 S.W. 2d 1004, wherein the Court said at page 1005:

> "The interviewing petition of Stavros makes no collateral attack on the settlement suit judgment . . . Appellant admits this Judgment is correct and his intervening petition does not attack it . . . The intervenor asks the court to construe the Judgment . . ."

In *Rocky Mountain Fuel Co. v. Heflin* (1961), 148 Colo. 415, 366 Pac. 2d 577, the Court rejected the collateral attack argument saying at page 579 and 580:

> "This action involves an interpretation of certain reservations in the trustee's deed and does not involve an attack on a decree of the United States District Court."

2. IT WAS SUFFICIENTLY SHOWN THAT THE CALIFORNIA COURT MADE A FINDING THAT THE CITY HAD PAID THE CONDEMNATION AWARD.

Plaintiff's Opening Brief insists that in any event, City did not carry its burden of proving that the State Court had adjudicated the fact of payment of the condemnation award.

This is untenable. It was clear on the record before the District Court that the State Court had made a Final Order of Condemnation and that it contained a finding that a valid payment of the condemnation award had been made by the City.

Under California law, the Final Order of Condemnation is by definition a determination that payment of the condemnation award has been made, and that title to the property is vested in the condemnor. Section 1253 of the California Code of Civil Procedure provides:

> "When payments have been made . . . as required by Sections 1251 and 1252, the court shall make a final order of condemnation. . . . The title to the property . . . vests in the plaintiff . . . upon the date that a certified copy of the final order is recorded . . .".

Plaintiffs' own complaint in this action alleged the entry of a final order of condemnation in the State Court pursuant to payment of the award (Tr. 18), hence the making of the finding or determination of payment, which is the essential function of the final order, was apparent from plaintiff's own complaint. Whether it had been done was not in issue. It was conceded.

If further proof were necessary, it was present. An exact copy of the Final Order was attached to the City's answer as Exhibit D (Tr. 29),[7] and the Court was able to see precisely what the State Court judgment had determined.

The cases cited by plaintiffs on this score are not pertinent. The case of *Johnston v. Ota* (1941), 43 Cal. App. 2d 94, is cited to the effect that the City failed in its burden of proving what the judgment determined. But that case involved a "judgment of dismissal" based upon an order of the Court sustaining a general demurrer. It could not be determined what was adjudicated for purposes of *res judicata* by such a judgment of dismissal, and the Court properly so held. Similarly, the decision in *Garcia v. Venegas* (1951), 106 Cal. App. 2d 364 involved not a judgment which contained express findings, but a "document certified by the justice of the peace as a transcript of the pleadings and proceedings as appeared from his docket", and from which it could not be determined whether the pertinent issues had even been determined by the earlier proceeding.

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3. OTHER GROUNDS ARE PRESENT FOR AFFIRMING THE JUDGMENT OF DISMISSAL.

In addition to the fact that the action was a collateral attack on the condemnation judgment of the

[7]The Exhibits to the Complaint and Answer were not duplicated in the copies made of the Transcript of the Record, but are attached to the original pleadings on file in the office of the Clerk of the Court of Appeals.

State Court, there were other reasons why the action could not be maintained. As these additional grounds were invoked by the City in support of its motion to dismiss in the District Court and were argued by the parties, the City reiterates them here in further support of the Judgment of Dismissal. The Court of Appeals should of course affirm the judgment if it was proper on any ground.

> "In the review of judicial proceedings the rule is settled that if the decision below is correct, it must be affirmed, although the lower court relied upon a wrong ground or gave a wrong reason." *Helvering v. Gowran* (1937), 302 U.S. 238, 245, 82 L.ed. 224, 230.

Accord, *J. E. Riley Invest. Co. v. Commissioner* (1940), 311 U.S. 55, 85 L.ed. 36; *Securities & Exchange Commission v. Chenery Corp.,* 318 U.S. 80, 87 L.ed. 626.

a. **The action is not maintainable unless the plaintiffs comply with Rule 23(b) of the Federal Rules of Civil Procedure.**

Considerable argument in the District Court was directed to whether the plaintiffs, who were not stockholders of Citizens of California but who were pledgees of the sole stockholder, were required to make the allegations required of a stockholder's derivative suit. (Rule 23(b), F.R.C.P.). The District Court pondered this question (Tr. 43 and 44) but in the end did not decide the point (Tr. 49 and 50) finding other grounds upon which to dismiss the action.

Rule 23(b) of the Federal Rules of Civil Procedure requires that a shareholder who brings an action

which may be brought by the corporation must make the following allegations:

> "(1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees, and, if necessary, from the shareholders such action as he desires, the reasons for his failure to obtain such action or the reasons for not making such effort."

Plaintiffs' complaint has no allegations complying with this rule.

The requirements of Rule 23(b) reflect the substantive rule of law that shareholders cannot independently sue on causes of action which belong to the corporation without first prevailing upon corporate officers to institute the litigation.

> "In the absence of statute, it is the generally accepted rule that misfeasance or negligence on the part of the managing officers of a corporation, resulting in loss of its assets, as alleged herein, is an injury to the corporation for which it must sue. A stockholder cannot sue for damages because his stock is thereby rendered worthless.
>
> "We find nothing in our statutory law opposed to the above conclusion." *Anderson v. Derrick* (1934), 220 Cal. 770 at 773 and 774.

> "Generally, a stockholder may not maintain an action in his own behalf for a wrong done by a third person to the corporation on the theory that such wrong devalued his stock and the stock of other shareholders, for such an action would authorize multitudinous litigation and ignore the corporate entity." *Sutter v. General Petroleum Corp.* (1946), 28 Cal. 2d 525, 530.

Accord, *Gagnon Co. Inc. v. Nevada Desert Inn* (1955), 45 Cal. 2d 448, at 453.

The general rule is the same throughout the United States.

> "In view of the legal concept of corporate entity under which stockholders as such lose their individualities in the individuality of the corporation as a separate and distinct person, and of the fact that stockholders by investing their money in the corporation recognize it as the person primarily entitled to control and manage its use for the common benefit of all the stockholders, it is a well-established general rule that a stockholder of a corporation has no personal or individual right of action against third persons, including officers and directors of the corporation, for a wrong or injury to the corporation which results in the destruction or depreciation of the value of his stock, since the wrong thus suffered by the stockholder is merely incidental to the wrong suffered by the corporation and affects all stockholders alike." 167 A.L.R. 279, at 280.

The wrong which plaintiffs complain of would of course be a wrong to the corporation, Citizens of California. The action is essentially a claim that the

water system was wrongfully taken from the corporation in that no valid payment of just compensation was made. If the deposit of $2,206,000 is "tainted" money and an ineffective payment of the condemnation award, the wrong is to Citizens of California. The corporation is the real party in interest, for if plaintiffs' action were successful in obtaining restoration, Citizens of California and not the plaintiffs would be entitled to it. The prayer of the complaint specifically asks for an adjudication (1) that the deposit of the $2,206,000 was not an effective payment to support the transfer of title and possession of the water system to the City (Tr. 23), (2) that the City holds the water system as trustee ex maleficio (Tr. 24), (3) that the conveyance of the water system is null and void, and that it be returned to Citizens of California (Tr. 24).

The question then is whether the plaintiffs, being not stockholders but pledgees of a stockholder, may bring an action for the recovery of corporate property without complying with Rule 23(b). In this connection, plaintiffs state on page 10 of their Brief that their standing to maintain the action "was conceded by the decision below," pointing to the lower Court's Memorandum dated January 30, 1963 (Tr. 43-45). This is not the case.

In the Memorandum referred to, the District Court noted some decisions which held that a pledgee of corporate stock had standing to sue and prevent the dissipation of the corporate assets, but it expressly

withheld its decision on whether it could be done *without* making the corporation a party and *without* complying with Rule 23(b), as plaintiffs are attempting to do here. In its final Memorandum granting the motion to dismiss the complaint, rendered on April 16, 1963, the Court characterized this question as one of the two principal issues confronting it, and expressly declined to rule upon it, having concluded that the action was not maintainable anyway.

> "Although there are a myriad of subordinate legal issues involved in this action, it appears to the Court that these issues boil down to but two, only one of which is of significance for present purposes. The two can be succinctly stated as follows: (1) Is an action of the nature of the present one properly brought by a pledgee as an individual, non-derivative action and without the joinder of the corporation whose shares of stock are involved; and (2) In an action of the present type, does the diversity jurisdiction of the federal courts require that this Court afford relief to plaintiffs. Since the Court has resolved the latter question in the negative, the former question need not be decided." (Tr. 49 and 50)

Several federal decisions have considered the nature of the action by the stock pledgee. However, no Court has ever had occasion to decide whether the pledgee must plead in accordance with Rule 23(b). They have, however, always characterized his standing to sue as being akin to that of a stockholder.

> "We think it beyond question that the pledgee of stock has such an equitable interest in it as

will entitle him to be heard in a court of equity concerning its preservation, and the protection of his interests therein, to the same extent, at least, as the stockholder pledging it would have." *Gorman Wright Co. v. Wright,* (4th Cir., 1904), 134 Fed. 363, 364.

"A pledgee of shares when the pledgor is insolvent has the standing of a shareholder for the purpose of protecting his interest." *Mutual Life Ins. Co. v. Menin* (2d Cir., 1940), 115 F. 2d 975, 980.

"It has been held by this court in Arcola Sugar Mills v. Burnham, 5 Cir., 67 F. 2d 981, that the pledgee of corporate stock could qualify under the rule (Rule 23 of the Federal Rules of Civil Procedure) and maintain such an action . . ." *Hurt v. Cotton States Fertilizer Co.* (7th Cir., 1944), 145 F. 2d 293, 295.

"It is not clearly true that the suit was not in behalf of the corporations, as separate legal entities, as well as in behalf of plaintiffs (pledgees)." *Cannon v. Parker* (5th Cir., 1945), 152 F. 2d 706, 708.

"In Arcola Sugar Mills Co. v. Burnham, 5th Cir., 67 F. 2d 981 it was held that the pledgee of shares could maintain a stockholder's suit in order to protect his interest and to prevent dissipation of the corporation's assets." *Weinhaus v. Gale* (7th Cir., 1956), 237 F. 2d 197, 200.

"In Arcola Sugar Mills Co. v. Burnham, 5th Cir., 67 F. 2d 981, it was held that the equitable interest of a mere pledgee qualified him under the rule (Rule 23(b)) to maintain such an action." *Richardson v. Blue Grass Mining Co.* (E. D. Ky. 1939), 29 F. Supp. 658, 665.

The pledgee cases which the plaintiffs refer to,[8] as well as the cases noted by the Court in its January 30, 1963 memorandum, do indeed hold that a pledgee of corporate stock may sue to prevent a dissipation or loss of the corporate assets, and the City does not dispute this principle. But the question here, which none of those cases decided, is whether the pledgee can bring such a suit without first prevailing upon the corporation to do so as required by Rule 23(b) and without making the corporation a party in the action. As the City pointed out in the District Court, in the cases holding that the pledgee may sue in the protection of his interest, they differed in two important respects from the present case, viz., it was apparent from those decisions that actual controversy existed between the pledgee and the corporation (or stockholder-pledgor) and the pledgee had brought both of them into Court as parties to the action. In *Cannon v. Parker* (5th Cir., 1946), 152 F. 2d 706, cited by plaintiffs as "analogous to the instant case" (Opening Brief, p. 11), the action was based upon the "dissipation of corporate assets" by the stockholder-pledgor, and other officers who were "looting the corporations", and the corporations were parties defendants. Plaintiff-pledgees could have, and from all that appears in the opinion did, plead in accordance with Rule 23(b) of the Federal Rules of Civil Procedure. *York Properties v. Neidoff* (1957), 170 N.Y.S. 2d 683, the other case cited by plaintiffs, was

[8] *York Properties, Inc. v. Neidoff,* 170 N.Y.S. 2d 683; *Cannon v. Parker* (5th Cir., 1945), 152 F.2d 706.

a case where the pledgee alleged and sued to stop active mismanagement of the corporate affairs by those in charge of the corporation, and the Court specifically held that the corporation was a necessary party defendant and had to be brought in by supplemental summons. The action was labeled in the report of the case as a "(d)erivative suit by pledgee of corporate stock."

In this case, neither the stockholder-pledgor nor the corporation are parties to the action, nor does it appear that they are at odds with the pledgee on whether the action should be brought. Plaintiffs neither bring the corporation before the Court so that the reasons for its inaction can be known, nor allege under Rule 23(b) that they attempted to prevail upon the corporation to bring the action.

The principle and purpose underlying Rule 23(b) require that a stock pledgee be made to plead in conformity with the Rule, at least where the pledgee does not join the corporation as a party and no reason appears in the complaint for the corporation's failure to bring the action. The reasons for the requirement were spelled out in *Hawes v. Oakland* (1882), 104 U.S. 450, 26 L.ed 827, from which Rule 23(b) is derived. 3 Moore's Federal Practice, § 23.15, p. 3490.

The first reason is that the stockholders should not institute and conduct litigation in the name of and on behalf of the corporation which its directors have declined to pursue as a matter of business judgment.

> ". . . there may be a variety of things of which a company may well be entitled to complain but

> which, as a matter of good sense, they do not think it right to make the subject of litigation, and it is the company as a company which has to determine whether it will make anything that is a wrong to the company a subject-matter of litigation or whether it will take steps to prevent the wrong from being done." 26 L.ed. at page 831.

Accordingly, to assure that the stockholder can press the corporation unwillingly into Court only where the conduct of those controlling the corporation is *ultra vires*, illegal, oppressive, or fraudulent, Rule 23(b) requires a shareholder to

> "set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort."

If a stock pledgee may ignore this requirement where the wrongful taking of or injury to the corporate property was done by a stranger to the corporation, where those controlling the corporation would logically be the first to seek redress, then the stock pledgee is permitted to ignore the will and judgment of the corporation; the reasoning that a stockholder should not do this applies equally to the pledgee of the stockholder, so the rule should also.

More importantly, a pledge of stock is a legal arrangement easily and commonly created by stockholders. If this Court holds that Rule 23(b) is in-

applicable to pledgees in this kind of case, a large and serious loophole is created. Shareholders would have an easy and obvious means of avoiding the rule of *Hawes v. Oakland.*

Secondly, the Supreme Court in *Hawes v. Oakland*, was concerned about stockholders bringing derivative suits only to bring the case into the Federal Court on diversity jurisdiction, when actually no diversity existed between the corporation and the adversary.

> "A corporation having such a controversy, which it is foreseen must end in litigation, and preferring for any reason whatever that this litigation shall take place in a Federal Court, in which it can neither sue its real antagonist nor be sued by it, has recourse to a holder of one of its shares, who is a citizen of another State. This stockholder is called into consultation, and is told that his corporation has rights which the directors refuse to enforce or to protect. He instantly demands of them to do their duty in this regard, which of course they fail or refuse to do, and thereupon he discovers that he has two causes of action entitling him to equitable relief in a court of chancery; . . ." 26 L.ed. at page 829.

The consequence of this consented-to but feigned jurisdiction is that

> "the overburdened courts of the United States have this additional important litigation imposed upon them by a simulated and conventional arrangement, unauthorized by the facts of the case or by the sound principles of equity jurisdiction." 26 L.ed. at page 829.

To avoid this, the Court said that the stockholders pleading should state "that the suit is not a collusive one to confer on a Court of the United States jurisdiction in a case of which it could otherwise have no cognizance . . .", and accordingly, Rule 23(b) requires such an allegation. To waive this requirement in the case of a stock-pledgee creates an additional loophole, for a corporation in dispute with a citizen in its own state, desiring that the litigation be in the federal court, may simply avoid the jurisdictional barrier by arranging institution of the litigation by a stock pledgee.

It is submitted that this Court should affirm the Judgment of Dismissal on the additional ground of the failure of the plaintiff-pledgees to plead in conformity with Rule 23(b), thus failing to state a claim upon which relief can be granted. The reasons requiring stockholders to comply with the Rule is fully applicable to the plaintiffs in this case. To permit pledgees to ignore the Rule would open the way to avoidance of it by stockholders, and permit collusion to obtain federal jurisdiction.

There is one additional point to be dealt with relative to plaintiffs' right to maintain the action. Plaintiffs sought to distinguish their action below from a stockholder's derivative action on the additional ground that under the Indenture of Mortgage and Deed of Trust, they were entitled to receive the condemnation award and it being "tainted" and subject to recovery by bondbuyers, they were thereby exposed to liability; that in the premises they were suing

in their own right, independent from any right of the corporation, preventing jeopardy to their security. This facade to plaintiffs' standing to sue reappears on page 3 of their Opening Brief, where they assert that

> "Plaintiffs are entitled, under the terms and provisions of the Indenture of Mortgage and Deed of Trust, to receive all of the proceeds resulting from condemnation of property of Citizens of California."

As was pointed out heretofore, the plaintiffs' claim to the condemnation award is grounded upon their agreement (Indenture of Mortgage and Deed of Trust) with the sole stockholder in Citizens of California and their right in that regard is no greater than that of the stockholder himself.

A stockholder has no separate or independent rights in corporate property, and cannot convey or agree to convey corporate property, *Gashwiler v. Willis* (1867), 33 Cal. 11. This principle is recognized everywhere:

> "The distinction between the title of a corporation, and the interest of its members or stockholders, in the property of the corporation, is familiar and well settled. The ownership of that property is in the corporation, and not in the holders of the shares of its stock." *Gibbons v. Mahon,* 136 U.S. 549 at 557, 34 L.ed. 525, 527.

> "Stockholders, even the controlling stockholder, cannot transfer or assign the corporation's properties and rights . . . By such a transfer no title is acquired by the transferee, since the transfer

> is not a corporate act." 1 Fletcher, Cyclopedia Corporations, section 31, page 115.
>
> "The same rules, as stated in the preceding section, necessarily apply to mortgages and pledges." Section 32, page 119.

The City of course has no concern or interest in whether Citizens of California or the plaintiffs ultimately in fact receive the condemnation award, but it does point out that the stockholder has taken it upon himself to declare a right in plaintiffs to the corporation's condemnation award, and plaintiffs' right thereto is therefore the same as, but no greater than, that of the stockholder would be. Such a declaration by the stockholder would be ineffective to create in himself any independent or personal action should the property be paid for with "tainted" money. The cause of action in such case is still within the corporation, and can be asserted by the stockholders only as a derivative suit, viz., in accordance with Rule 23(b). The standing of the plaintiffs is no different than this.

Plaintiffs' Brief also suggests that their standing is analogous to that of a mortgagee of corporate property, citing *Consolidated Water Co. v. City of San Diego* (S.D. Cal., 1878), 89 F. 272; *East River Savings Bank v. State,* 43 N.Y.S. 2d 703; and *Bunyan v. Commissioner of Palisades Interstate Park,* 153 N.Y. Supp. 622.

But no such analogy is appropriate, for as the Court said in the first of the above-cited cases, there is a

> "radical difference that exists between the relation of a stockholder to the corporation and that of the holder of its bonds secured by a mortgage. The interest conveyed by mortgage vests, in my opinion, in the mortgage a separate and independent interest, which the mortgagee has a separate and independent right to protect when unlawfully assailed." 89 F., at 273.

Plaintiffs as pledgees merely hold the stock of the shareholder as security for bonds issued by the shareholder. As beneficiaries of the shareholder's "assignment" to them of the proceeds of the condemnation award, they are merely assignees of the shareholder. In either case, they stand in the shoes of the shareholder, and can no more analogize their position to that of a *corporate* mortgagee than the shareholder himself might do. The shareholder could only bring this action in compliance with Rule 23(b) and by naming the corporation as a party, and it follows that plaintiffs must do likewise.

> ". . . what they (the shareholders) could not do themselves they could not by resolution or otherwise authorize another to do for them." *Gashwiler v. Willis* (1867), 33 Cal. 11, at 19.

b. The action should be dismissed because plaintiffs have failed to join indispensable parties.

The corporation is an indispensable party in a shareholder's derivative suit.

> ". . . it has been settled law for over a century . . . that the wronged corporation is an indispensable party to a shareholder's action." *Green-*

> *berg v. Giannini* (2nd Cir., 1944), 140 F. 2d 550, 554.
>
> "Manifestly the proceedings for this purpose should be so conducted that any decree which shall be made on the merits shall conclude the corporation. This can be done by making the corporation a party defendant . . . It would be wrong, in case the shareholders were unsuccessful to allow the corporation to renew the litigation in another suit, involving precisely the same subject matter." *Davenport v. Dows* (1874), 85 U.S. 626, 627, 21 L.ed. 938.

The corporation is likewise an indispensable party in a shareholder's suit under the law of California. *Beyerbock v. Juno Oil Co.,* 42 Cal. 2d 11, 265 P. 2d 1; *Keller v. Schulte,* 47 Cal. 2d 801, 306 P. 2d 430.

It is clear from a reading of the complaint in this action that Citizens of California is an indispensable party, whether or not the action is labeled a stockholder's derivative action. The gist of the action is that no valid payment of the condemnation award was made in the State Court condemnation proceeding between the City and Citizens of California. The complaint prays for judgment declaring that the deposit is not effective to transfer title to the water system, that the purported taking is an unconstitutional taking of the corporation's property, that defendants hold the water system as trustees, that they are not entitled to title and possession of the system, that the purported conveyance of the water system is null and void, and that the water system be returned to the

corporation (Tr. 23-25). The test this Court laid down in *State of Washington v. United States* (1936), 87 F. 2d 421, makes it clear that Citizens of California is an indispensable party.

> "After first determining that such party is interested in the controversy, the court must make a determination of the following questions applied to the particular case: (1) Is the interest of the absent party distinct and severable? (2) In the absence of such party, can the court render justice between the parties before it? (3) Will the decree made, in the absence of such party have no injurious effect on the interest of such absent party? (4) Will the final determination, in the absence of such party, be consistent with equity and good conscience?
>
> "If, after the court determines that an absent party is interested in the controversy, it finds that all of the four questions outlined above are answered in the affirmative with respect to the absent party's interest, then such absent party is a necessary party. However, if any one of the four questions is answered in the negative, then the absent party is indispensable." 87 F. 2d at 427.

The plaintiffs intimated to the District Court (Tr. 51) that they could avoid the problem of an absent indispensable party by waiving a portion of their requested relief. This is not the law,[9] but even if it

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[9]"It is the relief sought that determines indispensability . . ." *Pioche Mines v. Fidelity Trust Co.* (9th Cir., 1953), 202 F.2d 944, 948.

were, their skeletonized object is still a determination that the deposit of $2,206,000 was an ineffective payment and that *they* did not have to accept it. Whether plaintiffs accept the condemnation award is a matter of total indifference to the City and its officers; but a determination that no valid payment was made would collide directly with the State Court determination; and reopen the controversy over possession and title to the system. The finding would entitle Citizens of California to a return of the water system.

There is a separate reason that Citizens of California is indispensable. The requested relief would require the Court to adjudge that plaintiffs were entitled to receive the condemnation award made to Citizens of California upon the basis of an agreement with its sole stockholder. Citizens of California should be present if such a determination is made.

There is also absent from the litigation all of the persons who purchased or hold the City's Water Revenue Bonds. Despite their absence, the complaint seeks a determination that the bond sale was illegal and improper because of certain misrepresentations by the City (Tr. 21, par. 57 of complaint). This would be a direct adjudication of the rights and interests of the bondholders; if it is true, they should participate, yet not one of them is before the Court.

Plaintiffs apparently seek to avoid the consequences of their failure to join indispensable parties by characterizing their complaint as seeking "an *in personam* declaratory judgment against defendants . . ." (Opening Brief, page 2). That is to say, they ask the Court

to make a determination that the City did (or did not) make valid payment of just compensation to Citizens of California, but provide that it not be binding upon Citizens of California; and further, to make a determination that the City did (or did not) commit fraud upon the purchasers of the bonds, but provide that it not be binding upon the bond buyers. Obviously, such a position is absurd to the City, as it could then be required to relitigate those issues with the absent parties. That alone is sufficient to treat them as indispensable. The Supreme Court said in the similar case of *Niles-Bement Co. v. Iron Moulders Union* (1920), 254 U.S. 77, 65 L.ed. 145, that

> "any decree rendered would not prevent a relitigating of the same questions in the same or any other proper court, and it would settle nothing.
>
> "Thus, if the (absent party) be considered as having any corporate existence whatever separate from that of the petitioner, it must have an interest in the controversy . . . of a nature that such a final decree could not be made without affecting that interest, and perhaps not without leaving the controversy in a condition wholly inconsistent with that equity which seeks to put an end to litigation by doing complete and final justice; and therefore it must be concluded that it was an indispensable party, within the quoted long established rule." 254 U.S. at 81.

The Third Circuit ruled the same way in *Fitzgerald v. Haynes* (1957), 241 F. 2d 417, saying at page 419:

> "In the present case a decision on the merits in favor of the insurgent defendants would be an

> adjudication against the right of Locals 636 and 639, as now constituted, to union property. Yet, in the absence of those locals such an adjudication could not bind them or prevent them from relitigating the same controversy. Such considerations are most persuasive reasons for holding that the absent locals should be viewed as indispensable parties (citing cases)".

The absence of indispensable parties cannot be avoided by asking the Court for such a hollow judgment as plaintiffs propose. There is no valid reason why the Courts should determine the same issue three or more times and there is certainly no reason why the City should have to litigate the same issue over again with absent parties. There is no possible decree in this case that would be "consistent with equity and good conscience," nor can the Court "render justice between the parties before it", as it must be able to do under *Washington v. United States, Supra.* Both the corporation, Citizens of California, and the bondholders are indispensable parties.

When the plaintiffs fail to join an indispensable party, the action must be dismissed by the Court. *Shields v. Barrow,* 58 U.S. 130, 15 L.ed. 158; *Pioche Mines v. Fidelity Trust Co.,* (9th Cir,. 1953), 202 F. 2d 944; *Minnis v. Southern Pacific Co.* (9th Cir., 1938), 98 F. 2d 913; *State of Washington v. United States* (9th Cir., 1936), 87 F. 2d 421, 427; *Kohler v. McClellan,* 71 F. Supp. 308, 315 (corporation not made a party in a stockholder's suit). Hence, the judgment of Dismissal can be sustained on this separate ground.

c. Even if Citizens of California were joined in the action, it would have to be aligned as a plaintiff, and thus diversity jurisdiction would be destroyed.

An indispensable party in this instance, Citizens of California, is a California corporation (complaint, para. 10), hence is a citizen of California. 28 U.S.C. § 1332(c). Its principal place of business is in North Sacramento, California (complaint, para. 10), hence it can be sued within and is subject to the jurisdiction of the District Court for the Northern District of California, 28 U.S.C. § 1391(c); *Galveston, H. & S.A. Ry. Co. v. Gonzales,* 151 U.S. 496, 38 L.ed. 248, 14 S. Ct. 401.

The indispensable party being within the jurisdiction of this Court, the Court has the power to order it summoned to appear in the action, in lieu of dismissal, *Keene v. Hale-Halsell Co.* (5th Cir., 1941), 118 F. 2d 332, but in its discretion it need not do so, *U.S. v. Elfer* (9th Cir., 1957), 246 F. 2d 941, and if the presence of the indispensable party would eliminate diversity of citizenship, the action must be dismissed. *Gaw v. Higham* (6th Cir., 1959), 267 F. 2d 355; *Flaherty v. McDonald* (S.D. Cal., 1959), 178 F. Supp. 544.

The complaint alleges that the sale of the defendant city's water bonds was fraudulent and irregular, hence payment of the condemnation award with the proceeds thereof made the taking of the property of Citizens of California wrongful. It is not alleged that Citizens of California was a party to this wrongdoing, and it is not alleged that Citizens of California has refused to rectify this wrongful taking of its property.

The complaint is absolutely silent as respects Citizens of California, except for the prayer that the water system be returned to it. No cause of action in the plaintiff is stated against Citizens of California nor is any relief asked against Citizens of California. There is no sign of antagonism between it and plaintiff anywhere in the complaint.[10] The only thing that the complaint indicates is that Citizens of California, like the plaintiffs in this federal action, challenged the condemnation of the water system on many grounds. The doctrine of realignment requires a nominal defendant to be treated as a plaintiff for the purpose of defining the real controversy where no real cause of action is asserted against him by the plaintiff. *Indianapolis v. Chase National Bank,* 314 U.S. 63, 86 L.ed. 47, 62 S. St. 15.

> "The omission of any prayer for relief against the railroad simply shows that properly it is to be treated as a plaintiff in this case". *Steele v. Culver* (1908), 211 U.S. 26, at 29, 53 L.ed. 74, at 75.

Accord, *Green v. Green* (7th Cir., 1955), 218 F. 2d 130, at 139.

In this situation, it cannot be seriously questioned that the plaintiffs and Citizens of California have a common interest in the relief sought; and the latter, if made a party, would have to be aligned as a plaintiff for the purposes of testing jurisdiction. The controversy would then involve two citizens of the same state, to wit, California, thus destroying diversity and

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[10]Plaintiffs' attorneys are general counsel for Citizens of Delaware, parent company to Citizens of California.

the jurisdiction of this Court to proceed, *Dawson v. Columbia Avenue Savings Co.* (1904), 197 U.S. 178, 49 L.ed. 713; *Indianapolis v. Chase National Bank* (1941), 314 U.S. 63, 86 L.ed. 47.

In the *Dawson* case cited, there is a remarkably parallel situation, a suit brought by a mortgagee of a waterworks company against a city, naming the waterworks company as a defendant. The Court could see from the pleadings that the interest of the mortgagee and the waterworks company was the same, and dismissed the suit. Justice Holmes said:

> "If we assume that the plaintiff is more than an assignee of the city's contract to pay (which we do not intimate), still, when the arrangement of the parties is merely a contrivance between friends for the purpose of founding a jurisdiction which otherwise would not exist, the device cannot be allowed to succeed." 197 U.S. at 181, 49 L.ed. at 716.

Thus the District Court lacked jurisdiction in the absence of Citizens of California for want of an indispensable party, and would have lacked jurisdiction had that party been joined, for want of diversity. The Judgment of Dismissal should accordingly be affirmed on this additional ground.

d. Plaintiffs have not demonstrated that this action could be independently brought in a California Court.

In *County of Alleghany v. Mashuda Company,* 360 U.S. 185, relied on by plaintiffs as authority for Federal Courts to set aside State Court condemnations, the Court relied heavily on its conclusion that Penn-

sylvania law permitted a separate action to challenge the taking involved there. In that case, the Board of Commissioners of the county passed a resolution which had the effect of condemning Mashuda's land. Viewers were appointed to assess compensation, and both parties appealed from their award to the County Court of Common Pleas. Some time later Mashuda brought an action in Federal Court to determine the validity of the taking, on the ground that it was for private, not public, use. The Court of Appeals held, and the U.S. Supreme Court agreed, that a separate action to challenge the taking on this ground was clearly proper under Pennsylvania law, and that therefore the separate action could be brought in Federal Court, where diversity existed.

There the Federal Courts were dealing with the first judicial test of the validity of the taking, a matter which had not been determined by any Pennsylvania Court. It was dealing with a situation where state law contemplated that a judicial challenge to the right to take could be made in a separate action.

None of the circumstances of the *Mashuda* case are applicable here. Citizens of California had every opportunity to challenge the taking by motion to vacate the final order in the Trial Court, and on appeal. Plaintiffs do not find any provision in California law for a collateral attack on such a judgment; section 1252 provides for a direct attack on the judgment in the Court that rendered it in the event of nonpayment, which is claimed here, and there is no reason or precedent whatever for any other remedy. The

Supreme Court in the *Mashuda* case emphasized the importance of the possibility of collateral attack under state law to federal jurisdiction. The Federal Court could proceed if

> "the same suit to contest the validity of the taking could be brought in a state court different from the one in which the damage proceeding is now pending. It is perfectly clear under Pennsylvania law that the respondent could have challenged the validity of the taking . . . in a suit brought in a Court of Common Pleas independent of the damage proceedings pending . . ." 360 U.S., at page 190.

> "Respondents, it bears repetition, could have brought this very suit in a state court different from the one in which the damage proceeding is pending and an adjudication of that validity suit by the state court would have the same effect on the pending damage proceeding as will the federal court adjudication . . . considerations of comity are satisfied if the District Court acts toward the pending state damage proceedings in the same manner as would a state court." 360 U.S. at page 191.

Plaintiffs have not shown anywhere that their action could have been brought in a California Court different from that which rendered the condemnation judgment. In fact it could not be. *McPherson v. City of Los Angeles* (1937), 8 Cal. 2d 748.

As a final point, plaintiffs challenge the District Court's construction of *Thibodo v. United States*, 187 F. 2d 249 (p. 33 of Appellants' Brief) distinguishing *Thibodo* on the ground that theirs is an action based

upon diversity of citizenship. However, the District Court's only point was that *Thibodo* barred their action to the extent that jurisdiction might be founded upon the raising of a federal constitutional question, which plaintiffs do not assert here (Brief, pp. 1 and 2).

CONCLUSION

Plaintiffs, as pledgees and assignees of a stockholder, ask the federal court to redetermine issues that were formerly adjudicated by the California Superior Court in an action in which the corporation was a party, by a judgment from which the corporation appealed through the State Courts. They ask the Court to permit them to do so without their first asking the corporation to bring the action, and without their even making the corporation a party. Absence of the corporation and other parties whose rights and liabilities would be in issue can be cured, they say, on the theory that the judgment, while defining the rights of the absent parties against the City, will not be binding upon them nor the City. The plaintiffs ask the Court to spend its time and the City to expend its funds to litigate the contentions they raise, without settling anything.

The City spent nearly six years in the State Courts prosecuting the condemnation of the water system serving its inhabitants. Citizens of California prosecuted a seemingly endless procession of appeals on point after point, three times through the California

District Court of Appeal, and the California Supreme Court, and once to the United States Supreme Court, without ever having its contentions sustained. Against this background, the position of the plaintiffs, standing in the shoes of the sole stockholder of Citizens of California, that the condemnation judgment be reopened, the validity of the taking be again considered, the City's bonds invalidated and the system returned to Citizens of California, all without joining Citizens of California or any representative of the bondholders, accords with neither law nor justice.

The Judgment of Dismissal should be affirmed.

Dated, January 21, 1964.

Respectfully submitted,

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Attorneys for Appellee City of North Sacramento.

Certificate of Counsel

I certify that, in connection with the preparation of this Brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.

Martin McDonough.

No. 18,904

United States Court of Appeals

For the Ninth Circuit

MARINE MIDLAND TRUST COMPANY, etc., et al.,
Appellants,

vs.

CITY OF NORTH SACRAMENTO, etc.,
Appellee.

CITY OF NORTH SACRAMENTO, a municipal corporation,
Appellant,

vs.

MARINE MIDLAND TRUST COMPANY, etc., et al.,
Appellees.

ANSWERING BRIEF OF MARINE MIDLAND TRUST COMPANY, ET AL., RESPONDING TO CROSS APPEAL OF CITY OF NORTH SACRAMENTO

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ANSWERING BRIEF OF MARINE MIDLAND TRUST COMPANY, ET AL., RESPONDING TO CROSS APPEAL OF CITY OF NORTH SACRAMENTO

STATEMENT

Upon motion by the City of North Sacramento (hereinafter "Defendant City"), the United States District Court for the Northern District of California (Halbert, J.) entered judgment (TR 57) dis-

missing the complaint herein. An appeal has been taken from such judgment of dismissal by Marine Midland Trust Company (hereinafter "Plaintiff Marine Midland") and the other Plaintiffs, the cross-appellees herein (hereinafter all collectively referred to as "Plaintiffs").

Following the aforesaid dismissal of the Complaint, Defendant City moved for costs and for leave to file a counterclaim, which motion was denied. Defendant City of North Sacramento takes the instant cross appeal from the order denying its motion for costs and for leave to file a counterclaim against Plaintiffs for expenses resulting to Defendant City from the prosecution of the instant action by Plaintiffs.

Defendant City purportedly invoked the appellate jurisdiction of this Court pursuant to 28 U.S.C. § 1291.

STATEMENT OF THE CASE

The principal relief sought in the Complaint herein was a declaratory judgment concerning a sum of money now on deposit with the Clerk of the Superior Court of the State of California in and for the County of Sacramento (TR 23).

Said money had been deposited following the sale to The First Boston Corporation and Associates by Defendant City of Water Revenue Bonds to finance the acquisition of a water system owned by Citizens Utilities Company of California. Pursuant to an Indenture of Mortgage and Deed of Trust, Plaintiff Ma-

rine Midland would have been the recipient of such funds. However, various misrepresentations detailed in the Complaint and in Plaintiffs' brief on their appeal from the portion of the judgment dismissing the Complaint had been made to The First Boston Corporation and Associates, the purchaser of the Water Revenue Bonds, and their subsequent transferees, as a result of which it and its transferees may have rights of action against Defendant City for rescission of the bond purchases, for damages and otherwise. By the same token, the money received by the Defendant City from the defrauded bond purchaser was money burdened with these claims—tainted money. By reason of Plaintiffs' knowledge of the circumstances of Defendant City's obtaining that money, if Plaintiffs were to take or receive that money, they would subject themselves to liability therefor if actions were to be commenced by the aggrieved parties.

Accordingly, rather than take money affected by outstanding claims—tainted money—and thereby subject themselves to various forms of suits, Plaintiffs sought a declaratory judgment adjudicating the rights and obligations of the parties and specifically that the money on deposit in the Superior Court of the State of California is not money which can be tendered in payment of the obligation which it purports to discharge, by reason of its tainted nature.

Defendants first moved for summary judgment which motion was denied. The District Court thereafter entered judgment dismissing Plaintiffs' Com-

plaint herein after receiving a total of ten briefs concerning the issues raised thereby, seven submitted by Defendant City and three by Plaintiffs (TR 91-93), and after an unusual opinion requesting further briefing (TR 43-46) in connection with points which Defendant City had failed to discuss.

In the opinion dismissing the Complaint (TR 47-54), the District Court did not rely on any failure of the Complaint to state a meritorious cause of action but held merely that Plaintiffs were required to seek relief in the State Court.

It was in this context that the Court denied Defendant City's motions for leave to file a counterclaim pursuant to Rules 13(e) and 15(a) for recovery of its expenses and costs.

POINT I

THE DISTRICT COURT PROPERLY DENIED DEFENDANT CITY'S MOTION FOR LEAVE TO FILE A COUNTERCLAIM.

Defendant City attempted to assert its supposed counterclaim approximately 10 days after the District Court handed down its opinion dismissing the Complaint essentially on the ground that the action had been brought in the wrong forum. Defendant City's counterclaim purportedly arose under § 526b of the California Code of Civil Procedure, which provides as follows:

> "Every person or corporation bringing, instigating, exciting or abetting, any suit to obtain an injunction, restraining or enjoining the issuance, sale, offering for sale, or delivery, of bonds, or

> other securities, or the expenditure of the proceeds of the sale of such bonds or other securities, of any city, city and county, town, county, or other district organized under the laws of this State, or any other political subdivision of this State, proposed to be issued, sold, offered for sale or delivered by such city, city and county, town, county, district or other political subdivision, for the purpose of acquiring, constructing, completing, improving or extending water works, electric works, gas works or other public utility works or property, shall, if the injunction sought is finally denied, and if such person or corporation owns, controls, or is operating or interested in, a public utility business of the same nature as that for which such bonds or other securities are proposed to be issued, sold, offered for sale, or delivered, be liable to the defendant for all costs, damages and necessary expenses resulting to such defendant by reason of the filing of such suit."

It clearly appears from the discussion herein that the motion was properly denied for the following reasons, each of which is independently sufficient to sustain the District Court's decision:

(1) The supposed counterclaim (assuming arguendo that one could ever be asserted on this state of facts) had not yet matured because it had not been finally determined that Plaintiffs were not entitled to the relief they sought in this action; all that had been decided was that the District Court was not the proper forum to obtain such relief.

(2) No counterclaim could ever arise in favor of Defendant City against Plaintiffs under § 526b, C.C.P. because:

(a) The relief sought by Plaintiffs was merely declaratory, not the injunctive relief required by the statute;

(b) The securities issued by Defendant City for the purpose of acquiring the waterworks had already been issued before institution of Plaintiffs' action and thus the instant action could not possibly be construed as a suit to enjoin such a bond issue;

(c) Plaintiffs are not a private utility and therefore, pursuant to the California Supreme Court's construction of this statute, are not within its ambit; and

(d) The relief sought by Plaintiffs has not finally been denied, as is required under the statute.

A. The Supposed Counterclaim Could in No Event Be Deemed to Have Matured.

Rule 13(e) of the Federal Rules of Civil Procedure under which Defendant City seeks leave to file its purported counterclaim provides:

> "Counterclaim Maturing or Acquired After Pleading. A claim which either matured or was acquired by the pleader after serving his pleading may, with the permission of the court, be presented as a counterclaim by supplemental pleading."

"Of course," as stated in 3 *Moore's Federal Practice* (2nd ed. 1953), ¶13.32 at p. 85, "the counterclaim must have 'matured' before it can be pleaded under

Rule 13(e) even with the permission of the court." And it is well established that "[p]leading a claim for damages arising from the wrongful bringing of an action before the final determination thereof is premature and unauthorized by the Rules of Civil Procedure." *Goodyear Tire & Rubber Co. v. Marbon Corporation,* 32 F. Supp. 279, 280 (D.Del. 1940).

Accord:

Merz v. Merz White Way Tours, 166 F. Supp. 601, 602 (E.D. Pa. 1958);
Cyclotherm Corporation v. Miller, 11 F.R.D. 88, 89 (W.D. Pa. 1950);
Bach v. Quigan, 5 F.R.D. 34 (E.D.N.Y. 1945).

The hastiest perusal of the District Court's opinion herein shows that there has been no "final" determination on the merits in favor of defendant City and against Plaintiffs in this action. The District Court merely held that the Court in which the action was brought was the incorrect forum and that Plaintiffs were "required to intervene" in the proceedings in the state Courts (TR 54). This determination, although final for purposes of review by this Court, is obviously not a final determination of Plaintiffs' claim since even if the District Court's holdings on the issues appealed by Plaintiffs are upheld, Plaintiffs will merely be required to resort to the state courts.*

**A fortiori,* if this Court accepts Plaintiffs' contentions in the main appeal and holds that the Federal District Court must entertain this action, the District Court's action in denying Defendant City leave to file its counterclaim under C.C.P. 526b must be upheld since there has in that event been no final determination against Plaintiffs.

Likewise, under C.C.P. § 526b quoted in Defendant City's brief, no cause of action exists on behalf of Defendant City for expenses incurred in defense against Plaintiffs' suit unless and until the relief sought "is finally denied." In this connection, the California Supreme Court stated in *Sacramento M.U. District v. P.G. & E. Co.*, 20 Cal. 2d 684 (1942) (at p. 694):

> "The section establishes as a prerequisite to the recovery of those expenses that the private utility be unsuccessful thus indicating that its action was without legal foundation."

In the instant case, the District Court did not finally deny the relief sought or indicate that it considered Plaintiff's action to be non-meritorious. That Court merely required Plaintiff to seek its remedy in another forum. It is perfectly possible (if this Court upholds the District Court's determination appealed from by Plaintiffs) that Plaintiffs will intervene in the state Court proceedings and there obtain the relief they were unable to secure in the federal Court. Surely, under such circumstances it would be anomalous for Plaintiffs to be faced with a counterclaim such as this in the Federal District Court.

The requirement of maturity of counterclaims of Rule 13(e) is designed to prevent just such situations, and such requirement is ample basis for sustaining the portion of the District Court's judgment here at issue.

B. California Code of Civil Procedure § 526b Does Not Permit of a Counterclaim Under the Facts of This Case.

The District Court's determination denying leave to counterclaim should also be affirmed because Defendant City has no counterclaim as a matter of state law. Its purported counterclaim was clearly barred by any one of four separate requirements of the statute.

First, as Defendant City admits (Br. p. 7), the relief sought by Plaintiffs herein is declaratory. Since the statute creates a cause of action for expenses resulting from a suit against a city "to obtain an injunction," it is obvious that Defendant City has no cause of action here.

Second, and similarly, the statute only creates a cause of action if "bonds or other securities are proposed to be issued, sold, offered for sale or delivered" by a city for the acquisition of a public utility. In the instant case, the securities issued by Defendant City for the purpose of acquiring the waterworks which previously was owned by Citizens Utilities Company of California had already been issued, offered for sale, sold and delivered to The First Boston Corp. and Associates at the time of the institution of this suit (TR 12-14). A suit against the Defendant City at this stage no longer is covered by the statute.

The reason for the limited statutory coverage was given by the California Supreme Court in *Sacramento M.U. District v. P.G.&E. Co., supra,* at p. 694. The Court there stated that the purpose of the

statute was to discourage litigation by private utilities designed "to hamper and interfere with the development and operation of a public utility by a public agency, and thus either delay or forestall the day when its business would be wholly or partially destroyed by such threatened competition." This suit in no way forestalls or delays the acquisition or operation of the water system by Defendant City. The entire water system has been acquired by Defendant City, is in the possession of Defendant City, and is being operated by Defendant City (TR 20). Bonds for its acquisition have been issued, offered for sale, sold and delivered to First Boston Corp. and Associates (TR 12-14) without any attempt to enjoin such distribution. The bringing of this suit for a declaratory judgment, after all of the above events, offends no state policy and is plainly not covered by the language of the statute.

Third, the statute only creates a cause of action against a person or corporation who "owns, controls or is operating or interested in a public utility business of the same nature as that for which such bonds or other securities are proposed to be issued." The Supreme Court of California interpreting these words has stated that this language includes "only private utilities and such of those as operate within the area embraced by the public agency." *Sacramento M.U. District v. P.G. & E. Co., supra,* at p. 694. Marine Midland, against whom Defendant City seeks to interpose its counterclaim, is a lending institution and not a private utility (TR 1), nor is there the slightest

indication in the Record that any of the Plaintiffs control or operate private utilities. Plaintiffs' only connection with private utilities such as Citizens Utilities Company of California concerns Marine Midland's activities as a lender of money (TR 1-25). The statute does not give a city a cause of action against such a party.

Fourth, the statute only establishes a cause of action based on the improper institution of suit if the relief sought in such suit "is finally denied". As shown above, there has been no final denial of the relief sought by Plaintiffs, but merely a holding that they must repair to the state Court for a decision on the merits of their claim.

Moreover, even if there were any doubt whether a counterclaim against Plaintiffs is warranted by § 526b, and we submit there is not, the statute would have to be construed strictly in favor of Plaintiffs and against Defendant City. California C.C.P. § 526b, in creating a cause of action for attorneys' fees and other expenses resulting from litigation, establishes a penalty for the institution of baseless legal actions. *Marshall v. Foote,* 81 Cal. App. 98 (1st Dist. 1927). It has long been the rule in California that such statutes must be narrowly construed, the presumption being against the party seeking to enforce a penalty. In *Thompson v. San Francisco Gas & Electric Co.,* 20 C.A. 142 (1st Dist. 1921), the Court stated (p. 144):

> "Penalties are never favored either by courts of law or equity. Every intendment and presump-

> tion is against the person seeking to enforce the penalty or forfeiture provided by such a statute."

And the California Supreme Court stated in *Weber v. Pinyan,* 9 Cal. 2d 226, 229 (1937):

> "A statute creating a new liability or increasing an existing liability, or even a remedial statute giving a remedy against a party who would not otherwise be liable, must be strictly construed in favor of the persons sought to be subjected to their operation."

Accord:

Jones v. Allen, 185 C.A.2d 278, 281 (2d Dist. 1960);

Cantlay & Tanzola, Inc. v. Ingels, 31 C.A.2d 553, 556 (2d Dist. 1939);

Benbaugh Mortuary v. Barney, 196 C.A.2d 861, 864 (App. Dep't, Sup. Ct. 1961).

For all of the above reasons, the District Court not only soundly exercised its discretion by denying defendant City's motion for leave to file a counterclaim under the statute, but was obliged to deny said motion as a matter of law.

POINT II

THE DISTRICT COURT'S DENIAL OF COSTS TO DEFENDANT CITY WAS A SOUND EXERCISE OF ITS DISCRETION UNDER RULE 54(d), F.R.C.P.

Rule 54(d) of the Federal Rules of Civil Procedure, which governs the awarding of costs in suits such as the present, has "adopted for all suits covered

by it, the previous federal practice in equity according to which the trial court had wide discretion in fixing costs, a discretion not reviewable unless manifestly abused. . . ." *Harris v. Twentieth Century Fox Film Corporation,* 139 F.2d 571, 572 n. 1 (2nd Cir. 1943); see generally, 6 *Moore's Federal Practice,* ¶54.70[3] and cases therein cited.

The former equity rule, now governing all cases subject to the federal rules, was stated as follows in the leading case of *Bliss v. Anaconda Copper Mining Co.,* 167 F. 1024, 1028 (C.C.D. Mont. 1909):

> "The usual rule in equity is that the party found entitled should be reimbursed the expense of defending his rights. It is, however, a recognized doctrine that costs in equitable suits are subject to the sound judicial discretion of the court, and, where it appears that complainant had good reason to think the defendant was liable upon equitable principles, the court does not necessarily award costs against him, but may ascertain what sound discretion requires to be done under the facts of the case. It can be said that the questions involved in this litigation were not thoroughly well settled when this complainant brought his suit. There was wide room for difference of opinion. * * *
>
> "Upon careful consideration, I conclude that it is equitable that each party shall pay his and their own costs."

And this Court, quoting the United States Supreme Court, stated in *Alameda v. Parafine Companies,* 169 F.2d 409, 410 (9th Cir. 1948):

> "The Supreme Court has said of costs that 'Their allowance to the prevailing party is not, moreover, a rigid rule. Under the Federal Rules of Civil Procedure * * * the court can direct otherwise. Rule 54(d).' Fishgold v. Sullivan Corp., 328 U.S. 275, 284, 66 S.Ct. 1105, 1110, 90 L.Ed. 1230, 167 A.L.R. 110. Cf. Truth Seeker Co. v. Durning, 2 Cir., 147 F.2d 54; Shima v. Brown, 78 U.S. App. D.C. 268, 140 F.2d 337."

The Record on Appeal herein discloses that the District Court's refusal to tax defendants with costs was fully warranted. Prior to the District Court's decision on the motion appealed by Plaintiffs in the principal appeal herein, defendants had unsuccessfully attempted to secure dismissal of Plaintiffs' cause of action. In September 1962, defendants first moved for summary judgment and secured a stay of taking of depositions pending decision of such motion (TR 91). On November 19, 1962, the District Court denied defendants' motion for summary judgment holding that there were "certain material issues of fact as to the merits of this action which are in dispute" (TR 39-40). Thereafter, in December defendants filed their notice of motion to dismiss and/or for judgment on the pleadings (TR 92). Defendants submitted an opening memorandum, Plaintiffs filed a memorandum of law in opposition, and Defendants filed a reply memorandum (TR 92-93). The Court, however, not satisfied with the issues raised by defendants, found it necessary to request "further briefing" and to allude to specific points as to which it required clarification. Two further briefs were

submitted by Defendants and one by Plaintiffs (TR 93). Only thereafter, did the District Court enter judgment dismissing the Complaint (TR 47-54). Plainly, the District Court was of the opinion that Plaintiffs herein "had good reason to think the defendant was liable upon equitable principles." *Bliss v. Anaconda Mining Co., supra.*

Moreover, the District Court did not consider or in any way question the merits of Plaintiffs' cause of action. On the contrary, the District Court referred Plaintiffs to the state Court for their remedy. Under these circumstances, although defendants may be the "prevailing party" in a technical sense, they are certainly not yet the prevailing party in the controversy between the parties. Regarding such controversy, Plaintiffs have not yet had a day in Court.

Under these circumstances, and in light of the District Court's intimate knowledge of the history of this litigation, it is submitted that there has been no such "manifest abuse" of discretion as to require this Court to overturn the District Court's denial of costs to Defendants.

CONCLUSION

The judgment below insofar as it denied Defendant City costs and leave to file a counterclaim should be affrmed.

Dated, Sacramento, California,
January 15, 1964.

Respectfully submitted,
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GALLOP, CLIMENKO & GOULD,
Attorneys for The Marine Midland Trust Company of New York and John R. McGinley, as Trustees under a certain Indenture of Mortgage and Deed of Trust, dated as of the 1st day of March, 1947.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

WILKE, FLEURY & SAPUNOR,
By JOHN M. SAPUNOR.

United States Court of Appeals
FOR THE NINTH CIRCUIT

No. 18,904

MARINE MIDLAND TRUST COMPANY, etc., *et al.*,
Appellants,
vs.
CITY OF NORTH SACRAMENTO, etc.,
Appellees.

REPLY BRIEF OF APPELLANTS MARINE MIDLAND TRUST COMPANY, *ET AL.*

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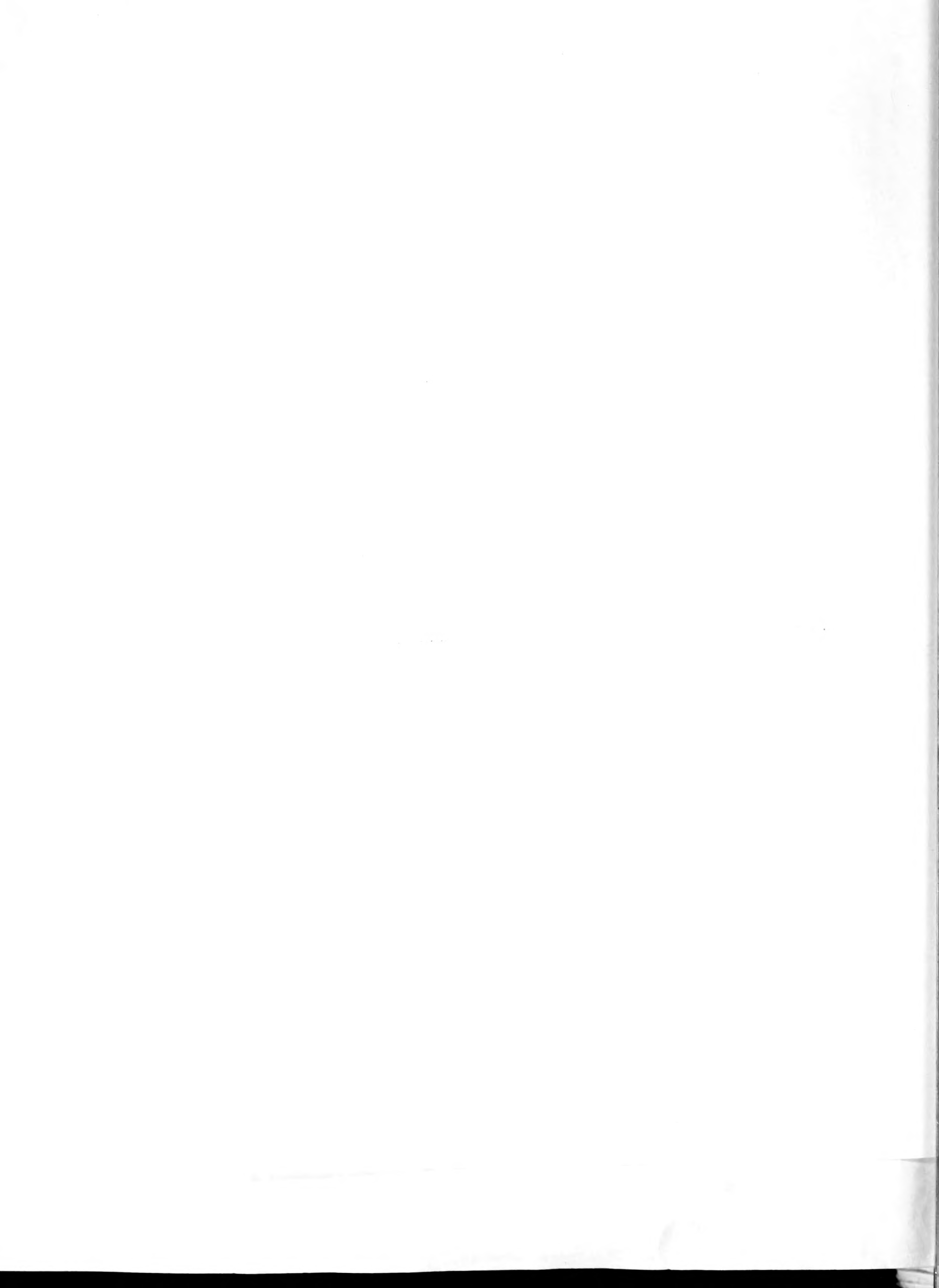

United States Court of Appeals
FOR THE NINTH CIRCUIT

No. 18,904

Marine Midland Trust Company, etc., *et al.*,
Appellants,

vs.

City of North Sacramento, etc.,
Appellees.

REPLY BRIEF OF APPELLANTS MARINE MIDLAND TRUST COMPANY, *ET AL.*

Preliminary Statement

Although purporting to rely upon the decision of the District Court below dismissing appellants' (herein "plaintiffs") complaint as insufficient, appellees' (herein "defendants") brief ranges far beyond the lower court's decisional grounds. Defendants now reargue questions of fact long since determined adversely to them not only by the district court's denial of their earlier motion for summary judgment, but also because their prevailing motion, having been addressed to the sufficiency of the complaint, presumes the truth of all allegations in the complaint. Defendants also belately seek to inject arguments never addressed to the district court.*

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* For example, defendants' brief (hereinafter "Def. Br."), at p. 36, contends, for the first time in this litigation, that purchasers of the revenue bonds in question are necessary parties to this action.

Our reply brief will first focus upon the basic distortion or misunderstanding of the nature of plaintiffs' claim, upon which all the arguments in defendants' brief—new and old alike—are premised. We urge that it will follow that the entire framework of argument defendants erect is specious and insubstantial.

POINT I

Defendants' brief ignores the true nature and basis of plaintiffs' claim.

Defendants' earlier motion for summary judgment was properly denied by the district court because it found issues of fact present. One of these issues of fact, vigorously argued in the court below, is whether plaintiffs were united in interest and in privity with Citizens Utilities Company of California (hereinafter "Citizens of California").

Defendants subsequently prevailed before the lower court on their motion attacking the sufficiency of the complaint under the Rule 12, F.R.C.P. But their brief tries (*e.g.*, Def. Br. at pp. 2-8) once again to probe the factual questions on which the lower court had previously precluded them. We respectfully suggest this is improper and should be disregarded for the purposes of this appeal.

Therefore, taking the allegations of the complaint at their face value, it is apparent that the nature of plaintiffs' claim below is completely misconstrued in defendants' brief. The substance of defendants' argument is summarized in the following quotation from their brief (Def. Br. p. 22):

> "The wrong which plaintiffs complain of would of course be a wrong to the corporation, Citizens of

> California. The action is essentially a claim that the water system was wrongfully taken from the corporation in that no valid payment of just compensation was made. If the deposit of $2,206,000 is 'tainted' money and an ineffective payment of the condemnation award, the wrong is to Citizens of California. The corporation is the real party in interest, for if plaintiffs' action were successful in obtaining restoration, Citizens of California and not the plaintiffs would be entitled to it."

A. The true nature of plaintiffs' claim.

Defendants' interpretation of the wrong of which plaintiffs complained below, is completely incorrect. The wrong was not to Citizens of California. Rather plaintiffs emphasized that *they* would be forced, as a direct result of fraudulent acts committed by defendants, to accept a fund of tainted money and that such possession would subject *them* to claims of various kinds.

It is quite true that Citizens of California might *ultimately* be one of the conduits through which this money would pass in reaching plaintiffs, pursuant to a pledge agreement to which plaintiffs and the parent company of Citizens of California are party. However, Citizens of California has not yet taken possession of nor received any of the tainted money in question and has not exercised any dominion over it. Therefore, plaintiffs, at this time, neither require nor have they requested any relief against Citizens of California, for they are presently threatened with no injury from that company. Plaintiffs would appear able to obtain complete relief from the threatened wrong by an *in personam* order of the district court requiring that defendants pay their obligations from a new fund of untainted money.

Defendants' brief makes much of the content of the complaint's prayer for relief. It argues, in effect, that the portion thereof requesting a declaration that the taking of the property of Citizens of California be held unconstitutional, must be viewed as defining the nature of plaintiffs' claim. Similarly, one of the principal grounds relied upon by defendants in arguing that plaintiffs lack standing to bring the present action, is that the prayer for relief, in part, requests relief of such a nature as would benefit Citizens of California. In fact, defendants' argument to the court below went so far as to describe the entire prayer of the complaint as though it sought only the restoration of the expropriated water system to Citizens of California. However, it is clear that any relief to Citizens of California which may be requested in plaintiffs' prayer is subsidiary and sought only as ancillary to plaintiffs' primary prayer that the money now on deposit in the court be declared an improper substitute for plaintiffs' prior security.

Even if a portion of the prayer for relief is excessive, unwarranted or otherwise improper, this would not be a ground for depriving plaintiffs of their day in court through a dismissal of the complaint. It is well-settled that a prayer for relief does not affect the validity of a complaint. (See *e.g., Truth Seeker Co., Inc.* v. *Durning,* 147 F. 2d 54, 56 (2d Cir. 1954); *Schoonover* v. *Schoonover,* 172 F. 2d 526, 530 (10th Cir. 1954); *Johnson* v. *Granquist,* 191 F. Supp. 591, 592 (D. Ore. 1961). The district court properly recognized this rule even though it found that plaintiffs were not entitled to the relief sought on the basis of the facts pleaded.

B. The nature of plaintiffs' claim precludes any argument that Citizens of California is an indispensable party or that it should be aligned with plaintiffs to defeat the district court's diversity jurisdiction.

Plaintiffs can obtain full relief from the threatened wrong referred to in their complaint through a declaratory judgment that need have no reference to Citizens of California. Unless and until the tainted funds in question are placed in possession of Citizens of California, that company has no necessary connection with the relief sought by plaintiffs. Nor is it necessary that Citizens of California, in its role as a mere conduit of funds, be directly concerned with any liability that might attach to the ultimate recipient of such funds.

The existence of a justiciable and valid claim to relief by plaintiffs and of plaintiffs' independent standing to maintain the present action for a declaratory judgment are demonstrated in Point I of plaintiffs' principal brief (pp. 8-12). Nevertheless, defendants' brief repeatedly tries to equate factually the interests of Citizens of California with those of plaintiffs so as to support the specious arguments that there is a complete "privity" between them. (See e.g., Def. Br. p. 10.)

But when defendants' conclusory and unsubstantiated averments of privity are ignored (as they must be on a motion addressed to the sufficiency of the complaint) it is clear that nothing in this record requires that Citizens of California be joined as an indispensable party to the action.

Contrary to defendants' principal argument, it is clear that plaintiffs' standing to bring this action in no way derives from any right of action accruing to Citizens of

California. The complaint establishes that the money deposited by defendants in supposed exchange for the taking of Citizens of California's property will ultimately be transmitted to plaintiffs. Plaintiffs' right to relief arises from the fact that defendants have thereby started in motion a train of events which, without the intervention of the court, would lead to the receipt of money by plaintiffs with knowledge of the wrong perpetrated by defendants in obtaining it. This constitutes a separate wrong done plaintiffs, whether they be denominated pledgees, shareholders, mortgagors, parties to an agreement, or anything else. There is, on the face of it, a substantial difference between the interests of plaintiffs and that of Citizens of California, for the latter may have no concern at all with the question of whether the money in the state court's registry is tainted.

Many decisions make it clear that where such a separate wrong exists, even a stockholder would be entitled to sue in his own right and would not be required to sue on behalf of the corporation. For example, in *Southern Pacific Co.* v. *Bogert,* 250 U. S. 483 (1919), Mr. Justice Brandeis stated (at p. 487):

> "The minority stockholders do not complain of a wrong done the corporation or of any wrong done by it to them. They complain of the wrong done them directly by the Southern Pacific [in wrongfully acquiring the corporation's bonds] and by it alone. The wrong consists in [Southern Pacific's] failure to share with them, the minority, the proceeds of the common property of which it, through majority stockholdings, had rightfully taken control."

This independent standing of an injured stockholder to sue in his own right has been given recognition in many

subsequent decisions, including New York cases.* For example, in *Sterne* v. *Orenstein,* 42 N.Y.S. 2d 314 (not officially reported) (Sup. Ct., N.Y. Co. 1943), the court stated (at p. 315):

> "The mere fact that there is a corporation involved and that there could be stockholders' actions brought for some of the wrongs alleged here is of itself no reason why the plaintiff, who was hurt individually, cannot bring an action such as this. If he was wronged individually, he has a remedy."

Likewise, in *Bunyan* v. *Commissioners of Palisades Interstate Park,* 167 App. Div. 457 (3rd Dept. 1915), the court stated (at pp. 459-60):

> "The next ground of challenge to this application is that these bondholders cannot bring this action without first having applied either to the corporation or to the mortgage trustee, and only then upon the refusal of such trustee to act. The corporation clearly does not represent the bondholders. A judgment against the corporation would have no effect whatever as against the bondholders, unless they were made parties to the action. The mortgage trustee represents them in a limited capacity. * * * That this action may be brought by the bondholders without a request to the trustee would seem to be held in the action of Carter *v.* Fortney (170 Fed. Rep. 463), and this decision was further sustained by the United States Circuit Court of Appeals in the same action under the title of *Fortney* v. *Carter* (203 id. 454)."

Similarly, in *Selman* v. *Allen,* 121 N.Y.S. 2d 142, 145 (not officially reported) (Sup. Ct., N.Y. Co. 1953), the Court stated:

> "There, of course, are many instances of direct wrongs to individual stockholders which give rise to

* As pointed out in plaintiffs' principal brief (at p. 10), New York law is controlling on the question of plaintiffs' independent standing to sue.

> an individual cause of action in favor of individual stockholders * * * Coronado Development Corp. *v.* Millikin, 175 Misc. 1, 4, 5, 22 N.Y.S. 2d 670, 673.
>
> "It is possible, too, for the same facts to constitute a wrong to the corporation and also to the individual stockholders, so that a stockholder may *elect* whether to sue in the right of the corporation for the wrong done to it *or* in his own right for the wrong done to him [citing several New York cases] * * * The right of election exists where the facts constitute a wrong to the stockholder individually as well as a wrong to the corporation." (Emphasis added.)

See also to the same effect *Perlman* v. *Feldman,* 219 F. 2d 173, 176 (2d Cir. 1955); *Landell* v. *Northern Pacific Railway Co.,* 98 F. Supp. 479 (D.D.C. 1951).

Since, as we have shown, plaintiffs have a claim which is "personal" to them and separate and distinct from any claim which may be advanced by Citizens of California, it must follow that Citizens of California is not an indispensable party to this action.

That prosecution of this action by plaintiffs may simultaneously confer a benefit upon Citizens of California impels no contrary conclusion. See the above-quoted portion of *Selman* v. *Allen, supra,* and cases therein cited; *Sterne* v. *Orenstein, supra,* at p. 315 ("The fact that a stockholder may bring an action on behalf of the corporation does not bar this action [citing cases]".)

This conclusion is also supported by the language of Mr. Justice Brandeis in *Southern Pacific Co.* v. *Bogert, supra* at (p. 492):

> "The Southern Pacific also urges that the suit must fail because the old Houston Company is an

> indispensable party and has not been joined. The contention proceeds upon a misconception of the nature of the suit. Since its purpose is merely to hold the Southern Pacific as trustee for the plaintiffs individually of the property which it has received, the old Houston Company is in no way interested and *would not even be a proper party.*" (Emphasis added.)

See also *Perlman* v. *Feldman, supra; Landell* v. *Northern Pacific Railway Co., supra.*

Defendants argue at length (Def. Br. pp. 28-29) that permitting a pledgee of stock to bring an action without joining the pledgor corporation would create a loophole to Rule 23(b), F.R.C.P. Whatever may be the merits of this argument, it clearly has no application here where the plaintiffs' right of action is not derived from the corporation's, but exists irrespective of plaintiffs' status as stockholder, pledgee, or any other connection with the corporation in question.*

Thus, it is quite apparent that the question before this Court, no matter what the plaintiffs may be called—whether stockholders, pledgees, or anything else—is merely: does the complaint allege that plaintiffs have themselves been injured or are threatened with injury as a result of the wrong committed by defendants? The answer must clearly be in the affirmative.

The district court refused to rest its dismissal of the complaint on any finding that Citizens of California was an indispensable party to the action. This refusal was clearly correct in view of the well recognized principle

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* As defendants themselves point out in their brief, plaintiffs have no connection whatsoever with Citizens of California; their claim arises out of an agreement with the parent company of Citizens of California.

that Federal district courts will strain to avoid having their diversity jurisdiction ousted by any such finding concerning indispensable parties. Thus, where a party is merely "necessary", but not "indispensable" it is clear that Federal courts, wherever possible, will proceed without such party to avoid having its jurisdiction defeated. See *e.g., State of Washington* v. *United States,* 87 F. 2d 421 (9th Cir. 1936); *Dunham* v. *Robertson,* 198 F. 2d 316, 319 (10th Cir. 1952).

One of the primary elements to which courts will look in determining whether a party is merely a necessary one or is indispensable to an action, is the factual question of whether a decree made in the absence of such party would necessarily injure it. *State of Washington* v. *United States, supra,* pp. 427-428.

Defendants argue at length that the interests of plaintiffs and of Citizens of California are indentical. They further urge that such identity of interest must be taken into account in aligning the parties, and that this community or identity of interest must defeat diversity upon a ruling that Citizens of California is an indispensable party.

However, to the extent that the interests of plaintiffs and of Citizens of California are, in fact, parallel, as alleged by defendants, no prejudice can result to Citizens of California by its being omitted from this action. To this extent, Citizens of California should not be deemed an indispensable party in this action.* If, on the other hand, defendants still insist that prejudice will result to Citizens of California by virtue of its being omitted from the

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* Plaintiffs, in reliance on Mr. Justice Brandeis' statement in *Southern Pacific* v. *Bogert,* quoted, *supra,* would take the further position that Citizens of California is not even a *necessary* party to this action, to say nothing of being an *indispensable* party.

present action, this can only be by virtue of the fact that Citizens of California has interests adverse to those of plaintiffs. If this be the case, it would then obviously be improper to align Citizens of California on the side of plaintiffs in determining the question of diversity. See e.g., *Smith* v. *Sperling,* 354 U. S. 91, 97, 98 (1957); *Doctor* v. *Harrington,* 196 U. S. 579, 587-88 (1905).

Citizens of California, although not actually in voluntary conflict with plaintiffs, could eventually be forced by the requirements of the trust indenture to participate in the delivery of the tainted money, which it may hereafter receive, to plaintiffs. This also would constitute an act sufficiently adverse to plaintiffs' interests to require aligning Citizens of California as an opposing party for the purposes of determining diversity. Cf. *Foster* v. *Carlin,* 200 F. 2d 943, 951-52 (4th Cir. 1952).

POINT II

There is no merit to defendants' argument that this action is barred by the state court's condemnation judgment.

The discussion under POINT I hereinabove clearly demonstrates the independent nature of plaintiffs' claim and plaintiffs' standing to sue in their own right, independent of any relation with or rights derivative from Citizens of California. Plaintiffs' principal brief (POINT II, at pp. 12-33) has also conclusively shown that no issues of fact relevant to plaintiffs' claims herein were or could have been raised before or passed upon by the state court in connection with that court's interlocutory judgment of condemnation—the judgment allegedly collaterally attacked by this action.

The foregoing constitutes a full and complete answer to defendants' specious arguments set forth as the foundation-stone of their brief (see Def. Br. pp. 8 *et seq.*) that the present action represents a collateral attack on the state court judgment.

Defendants' aforesaid arguments (e.g. Def. Br. pp. 11-12), moreover, are erected on an artificial edifice of language, pulled out of context, relating to the *res judicata* effect of decrees on parties to the action in which such decrees were entered, which is, of course, completely irrelevant to this case. No citation of authority is needed to support the proposition that the principle of *res judicata* thus relied upon by defendants has no application whatsoever to persons, such as plaintiffs, who were not parties to the previous action or to a claim completely distinct from anything litigated in the previous action.

Moreover, applicable authorities make it clear that even if the privity between the plaintiffs and Citizens of California, which defendants' brief so groundlessly persists in urging, did actually exist, plaintiffs would nevertheless not be barred from maintaining the present action.

Defendants' principal contention underlying their estoppel argument is that plaintiffs are seeking, by means of the instant action, to relitigate a defense which Citizens of California could have interposed in the state court condemnation action. They go on to urge that the state court judgment is, accordingly, effectively *res judicata* in respect of all the issues in this action (Def. Br. p. 12).

This argument, however, ignores or pretends to ignore, the highly significant fact that a state court condemnation action is an *in rem* proceeding which thereby makes ordinary rules of *res judicata* inapplicable. It follows from the *in rem* nature of the state court judgment that plain-

tiffs, as strangers to the state court decree, would normally be bound only by the ultimate facts established thereby and not by subordinate questions of fact or law. Even were plaintiffs determined to be in privity with Citizens of California in the state action, applicable authorities indicate that as a result of the *in rem* nature of that proceeding, plaintiffs would not be barred from asserting their present claim, since it was neither litigated nor determined in the state action.

A. Plaintiffs are strangers to the state court's *in rem* decree and are thus not bound by any subsidiary issues which the decree may have determined.

There can be no dispute that the state condemnation action was an *in rem* proceeding. *Boyle-LaCoste* v. *Superior Court,* 46 Cal. App. 2d 636, 642 (1st Div. 1941). Accord: *Harrington* v. *Superior Court,* 194 Cal. 185, 189 (1924).

It follows that plaintiffs are not bound by any "implied" findings that might be read into such a decree, for it is also clear that strangers to an *in rem* decree are bound only by the ultimate fact established by such decree and not by subordinate determinations of questions of law or fact. See, e.g., *Gratiot State Bank* v. *Johnson,* 249 U. S. 246, 248, 249 (1919); *Estate of Bloom,* 213 Cal. 575, 578 (1931); California Code of Civil Procedure, § 1908.

Thus, in *Estate of Bloom, supra,* the California Supreme Court stated (at p. 578):

> "* * * strangers though bound to admit the title or status which the [*in rem*] judgment establishes are not bound by the findings of fact."

Similarly, Mr. Justice Brandeis, in *Gratiot State Bank* v. *Johnson, supra,* while stating with reference to an *in rem*

decree that (p. 248) "even strangers to the decree may not attack it collaterally" also held (at p. 249) that a stranger "is unaffected by the decision of even essential subsidiary issues."

This distinction between *in rem* and *in personam* actions is given explicit recognition by the Calfornia Code of Civil Procedure which provides (§ 1908):

> "The effect of a judgment or final order in an action or special proceeding before a Court or Judge of this state, or of the United States, having jurisdiction to pronounce the judgment or order, is as follows:
>
> "One—*In case of a judgment or order against a specific thing,* or in respect to the probate of a will, or the administration of the estate of a decedent, or in respect to the personal, political or legal condition or relation of a particular person, *the judgment or order is conclusive upon the title to the thing,* the will or administration, or the condition or rela tion of the person.
>
> "Two—In other cases, the judgment or order is, in respect to the matter directly adjudged conclusive between the parties and their successors in interest by title subsequent to the commencement of the action or special proceeding, litigating for the same thing under the same title and in the same capacity, provided they have notice, actual or constructive, of the pendency of the action or proceeding." (Emphasis added.)

Granting defendants the benefit of every doubt, it is clear that the ultimate fact or title determined by the state court decree allegedly collaterally attacked by this proceeding was that the City of North Sacramento had the right and power to condemn the waterworks

previously owned by Citizens of California. Any finding concerning the existence or nonexistence of improprieties in obtaining the money which was deposited in the registry of the state court was necessarily subsidiary to the Condemnation Court's ultimate finding of title in City of North Sacramento.

The cases above cited also defeat any argument that defendants are bound by a finding of validity of payment even if such finding were an essential underpinning to the *in rem* decree. See also, *Becher* v. *Contoure Laboratories,* 279 U. S. 388 (1929), in which Mr. Justice Holmes stated (at p. 391):

> "* * * [a] judgment *in rem* binds all the world but the facts on which it necessarily proceeds are not established against all the world."

Defendants have attempted to avoid the force of this rule by contending that plaintiffs herein were in privity with Citizens of California in the state condemnation action. The language of the district court's decision negates this argument, inasmuch as it explicitly states (Tr. 49):

> "Plaintiffs herein were not a party to the condemnation action in the Superior Court."

So also does that court's earlier denial of defendants' motion for summary judgment. Nevertheless defendants attempt to find support for their argument in *Gagnon Inc.* v. *Nevada Desert Inn, Inc.,* 45 C. 2d 448, 453 (1955), a shareholder's derivative suit in which the Court held that shareholders suing on behalf of a corporation were precluded from their suit by a previous judgment against the corporation on the same cause of action. This case supports plaintiffs' position, rather than that of defend-

ants. For, the rule of privity applies only when the "same legal rights" have been represented at a previous trial. *Dillard* v. *McKnight,* 34 C. 2d 209, 215 (1958). In the instant case, there is no basis for any assertion that plaintiffs' interests were represented in the *in rem* proceeding. As heretofore discussed, plaintiffs, as pledgees, have an individual right of action completely unrelated to any right of action of the corporation based both on the impairment of their security interest and on the threatened receipt of a fund of tainted money, unlike shareholders whose standing in a derivative suit "derives" from an injury to the corporation.

Defendants also contend that the state *in rem* decree bars all matters which *might* have been raised by plaintiffs herein (Def. Br. p. 11). Such a rule would require strangers to an *in rem* proceeding to intervene in that proceeding in order to protect themselves from preclusion of a later action based on associated *in personam* claims. The Supreme Court, by Mr. Justice Brandeis, squarely rejected such a contention in *Gratiot State Bank* v. *Johnson,* 249 U. S. 246 (1919), stating (at pp. 249-50):

> "The trustee contends, however, that since by §§18b and 59f of the Bankruptcy Act, any creditor is entitled to intervene in the bankruptcy proceedings, the Bank should be considered a party thereto. These sections are permissive, not mandatory. They give to a creditor, who fears that he will be prejudiced by an adjudication of bankruptcy, the right to contest the petition. Whether he does so or not, he will be bound, like the rest of the world, by the judgment, so far as it is strictly an adjudication of bankruptcy. But he is under no obligation to intervene, and the existence of the right is not equivalent to actual intervention. Unless he exercises the right to become a party, he remains a stranger to the

> litigation and, as such, unaffected by the decision of even essential subsidiary issues. *In re McCrum*, 214 Fed. Rep. 207, 213; *Culinane* v. *Bank*, 123 Iowa, 340, 342. The rule is general that persons who might have made themselves parties to a litigation between strangers, but did not, are not bound by the judgment."

By the same token, plaintiffs herein should not be bound by subsidiary determinations of issues which they arguably could have raised, but did not.

B. Even if plaintiffs were in privity with Citizens of California, they would not be bound by any implicit determination as to the validity of the payment into the registry of the state court since that issue was neither litigated before, nor determined in, the state court *in rem* condemnation proceeding.

Even if it be assumed *arguendo* that plaintiffs were in privity with Citizens of California in the state *in rem* proceeding, they would still not be debarred from this action for, as heretofore discussed, it is clear that the issues raised by the instant suit were neither litigated nor decided in the state action.

It is true that an *in rem* action bars parties, privies and even strangers as to the ultimate fact determined therein. It also bars parties and privies as to facts actually litigated and decided therein. However, even parties and privies are not bound by subordinate findings in the *in rem* action which were never litigated and decided. See, *e.g.*, *Friend* v. *Talcott*, 228 U. S. 27 (1913); *Myers* v. *International Co.*, 263 U. S. 64 (1923); *Headen* v. *Pope & Talbott, Inc.*, 252 F. 2d 739, 744-45 (5th Cir. 1958); *United States* v. *Verrier*, 179 F. Supp. 336 (D. Me. 1959); Restatement, Judgments §73 (1942 ed.).

The rule is succinctly stated in the Restatement of Judgments, *supra,* as follows:

> "§73. Proceedings With Respect to Property.
>
> "(1) In a proceeding in rem with respect to a thing the judgment is conclusive upon all persons as to interests in the thing.
>
> "(2) *A judgment in such a proceeding* will not bind any one personally unless the court has jurisdiction over him, and it *is not conclusive as to a fact upon which the judgment is based* except between persons who have actually litigated the question of the existence of the fact." (Emphasis supplied.)

In this connection compare *Friend* v. *Talcott, supra* (where an *in personam* action based on claims associated with a prior *in rem* action was held not barred because the issues raised in the *in personam* action had not been litigated and decided in the *in rem* action) with *Myers* v. *International Co., supra* (where an *in personam* action following an *in rem* action was held barred because the issues raised in the later *in personam* action had been litigated and decided in the *in rem* action.)

Our case is clearly governed by *Friend* v. *Talcott* because as defendants concede (Def. Br. p. 12):

> "Citizens of California did not raise the contentions respecting the validity of payment [in the state action] that plaintiffs have raised in the federal action."

It is also abundantly clear that no such determination would ordinarily be made in a state condemnation action and that none was in fact, made in this action. Therefore, under the rule of both *Friend* v. *Talcott* and *Myers* v. *International Co.,* plaintiffs herein are not precluded from

maintaining the present *in personam* action because, even if they were in privity with Citizens of California, that company never litigated the issue raised by the instant action and such issue was never decided by the state court.

It should be noted also that all of the cases cited by defendants in support of their argument (Def. Br. p. 11) that the judgment in the *in rem* condemnation action is "final not only as to all questions which were actually raised but as to all questions and contentions which could have been raised," involved *in personam* determinations. As hereinabove noted, the ordinary rules of *res judicata* in *in personam* actions do not apply to *in rem* actions.

Myers v. *International Co.*, 263 U. S. 64 (1923) supplies an additional refutation of defendants' argument. There it was determined in an *in rem* bankruptcy proceeding that certain statements of the bankrupt to one creditor had not been fraudulent. Subsequently that creditor commenced a separate action in deceit. The Court in *Meyers* held that plaintiff was barred because (unlike our own case) the issue sought to be raised in the subsequent *in personam* action had been litigated by plaintiff and decided adversely to plaintiff in the previous *in rem* proceeding. The court noted, however, that plaintiff was not barred by *res judicata* because his *in personam* action was not on the same cause of action as the previous *in rem* suit. The court quoted the relevant principles and applied them as follows (pp. 70-71):

> "The general principles which must govern here are laid down in an oftquoted opinion of Mr. Justice Field in Cromwell *v.* Sac County, 94 U. S. 351. In that case suit had been brought upon coupons attached to bonds issued by the county for the

erection of a school house, and it was adjudged that the bonds and coupons were invalid in the hands of one not a *bona fide* holder for value before maturity, and as the plaintiff had not shown himself to be such a holder, he could not recover. In a second suit on other coupons from the same bond, he proved that he was a holder for value before maturity and the county sought to defeat the second suit by pleading the judgment in the first as *res judicata.* It was held that the cause was different and that the first judgment was not a bar. Mr. Justice Field said (pp. 352, 353):

'In considering the operation of this judgment, it should be borne in mind, as stated by counsel, that there is a difference between the effect of a judgment as a bar or estoppel against the prosecution of a second action upon the same claim or demand, and its effect as an estoppel in another action between the same parties upon a different claim or cause of action. In the former case, the judgment, if rendered upon the merits, constitutes an absolute bar to a subsequent action. It is a finality as to the claim or demand in controversy, concluding parties and those in privity with them, not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissible matter which might have been offered for that purpose * * *

'But where the second action between the same parties is upon a different claim or demand, the judgment in the prior action operates as an estoppel only as to those matters in issue or points controverted, upon the determination of which the finding or verdict was rendered. In all cases, therefore, where it is sought to apply the estoppel of a judgment rendered upon one cause of action, the inquiry must always be as to the point or question actually

litigated and determined in the original action, not what might have been thus litigated and determined. Only upon such matters is the judgment conclusive in another action.' See also Southern Pacific R. R. Co. *v.* United States, 168 U. S. 1, 50; Troxell *v.* Delaware, Lackawanna & Western R. R. Co., 227 U. S. 434, 440.

"*Coming now to apply these principles to the case before us, it is very clear that the opposition to the composition in the bankruptcy court was not the same cause of action as the suit for deceit here.* That is settled by the decision of this Court in *Friend* v. *Talcott,* 228 U. S. 27, in a case involving similar facts, to be more fully stated. The defense of res judicata as to the cause was therefore, not established by the judgment confirming the composition." (Emphasis supplied.)

The crucial point to be noted is that the Court, even though later in its opinion, holding that plaintiff's claim in its subsequent *in personam* action was barred by collateral estoppel, found it "very clear" that plaintiffs' appearance and opposition to the order in the *in rem* bankruptcy action "was not the same cause of action as the [*in personam*] suit for deceit here." Consequently the bar was not that of *res judicata* which concludes "parties and those in privity with them not only as to every matter which was offered and received to sustain or defeat the claim or demand, but also as to any other admissible matter which might have been offered for that purpose." The court only found in *Meyers,* that plaintiff was barred by *collateral estoppel,* which bars relitigation only "of the point or question actually litigated and determined in the original [*in rem*] action, not what might have been thus litigated and determined."

The *Myers* case, *supra,* clearly demonstrates the inapplicability to our case of the principle of *res judicata,* upon which defendants' argument primarily rests. The inapplicability of the even narrower principle of collateral estoppel is shown both by *Gratiot State Bank* v. *Johnson,* 249 U. S. 246 (Point II-A, *supra*) and by *Friend* v. *Talcott,* 228 U. S. 27.

CONCLUSION

The judgment below dismissing the complaint for failure to state a claim upon which relief can be granted should be reversed.

Dated: Sacramento, California,
February 19, 1964.

Respectfully submitted,

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Certificate

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

WILKE, FLEURY & SAPUNOR,

By ~~JOHN M. SAPUNOR~~, JOE S. GRAY

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No. 18,904

United States Court of Appeals

For the Ninth Circuit

MARINE MIDLAND TRUST COMPANY, etc., et al., *Appellants,* vs. CITY OF NORTH SACRAMENTO, etc., *Appellee.*	
CITY OF NORTH SACRAMENTO, a municipal corporation, *Appellant,* vs. MARINE MIDLAND TRUST COMPANY, etc., et al., *Appellees.*	

On Appeal from the United States District Court for the Northern District of California, Northern Division

REPLY BRIEF OF APPELLANT CITY OF NORTH SACRAMENTO

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On Appeal from the United States District Court for the Northern District of California, Northern Division

REPLY BRIEF OF APPELLANT CITY OF NORTH SACRAMENTO

INTRODUCTION

This is the Reply Brief of Appellant City of North Sacramento (''City'') on its appeal relative to its counterclaim and costs, and is in response to the ''An-

swering Brief of Marine Midland Trust Company, et al., responding to Cross Appeal of City of North Sacramento," dated January 15, 1964 (hereinafter referred to as "Answering Brief"). The headings "Point I" and "Point II" refer to the points under those headings in the Answering Brief.

POINT I

A. THE CITY'S COUNTERCLAIM HAD MATURED.

City agrees that a counterclaim must have matured before it can be filed under Rule 13(e), but the City's had matured in this instance. The District Court entered its Judgment of Dismissal on April 26, 1963 (Tr. 57), and the City did not seek to file its counterclaim until after that, on May 6, 1963. (Tr. 58.) In the cases cited by plaintiffs, the party sought to file a counterclaim arising out of the bringing of the main action, while the main action was *still pending*. In *Goodyear Tire v. Marbon,* 32 F.Supp. 279, defendant attempted to file a counterclaim for damages resulting from the Court's granting a preliminary injunction, while the action in which the injunction was issued was still pending. The counterclaimant's right to relief was unquestionably "dependent upon plaintiff's failure to prevail in the case at bar." (32 F.Supp., at 280.) In *Merz v. Merz White Way Tours,* 166 F.Supp. 601, defendant filed the counterclaim with his answer, for malicious abuse of process in bringing the action. The District Court dismissed the counterclaim because "the essential element of

such a cause of action is that the initial suit giving rise to the cause of action must have terminated in favor of the counterclaimant" (166 F.Supp. 601), and that had not yet occurred.

Similarly, in *Cyclotherm Corp. v. Miller,* 11 F.R.D. 88, "(t)he counterclaim asserted by the defendant (was) dependent upon his failure to prevail in the still pending suit in the State Court," and in *Bach v. Quigan,* 5 F.R.D. 34, the counterclaim was based on malicious abuse of process for bringing the still pending principal action.

In this case, the District Court had entered the judgment dismissing plaintiffs' action before the City made its motion to file the counterclaim.

Plaintiffs next argue that in order for C.C.P. 526(b) to apply, their action must have been defeated on the merits, whereas all the District Court decided in this case was that they brought their action in the wrong forum.

We have read and re-read Section 526(b), but are unable to find where it says that the action must be defeated "on the merits." The statute plainly says that if the injunction is finally denied, the City has its right of action. It does not deal with the basis for the denial, and therefore a denial upon any basis or for any reason must be deemed to make the statute operative.

> "In the construction of a statute or instrument, the office of the judge is simply to ascertain and declare what is in terms or in substance contained

> therein, not to insert what has been omitted, or to omit what has been inserted;" C.C.P. 1858.
>
> "In construing the statutory provisions a court is not authorized to insert qualifying provisions not included and may not rewrite the statute to conform to an assumed intention which does not appear from its language. The court is limited to the intention expressed." *Vallerga v. Dept. Alcoholic Bev. Control* (1959), 53 C.2d 313, at 318.
>
> "The general rule is that a court is not authorized in the construction of a statute, to create exceptions not specifically made. If the statute announces a general rule and makes no exception thereto, the courts can make none." *Stockton Theatres v. Palermo* (1956), 47 C.2d 469, 476.

Further, the purpose of 526(b) does not require the construction contended for by plaintiffs. The statute is intended to shield the City from the cost and burden of plaintiffs' mistakes and errors in prosecuting an action against it, and it makes no difference whether the action is defective on substantive or procedural grounds, whether it fails on the merits or for want of jurisdiction. The responsibility for bringing the action in the right court is upon the plaintiffs. There are a host of reasons why an action may fail, independent of its "merits." There is standing to sue, jurisdiction of the Court, statute of limitations, omission or misjoinder of parties, another action pending, res judicata, to name only a few. If an action is within 526(b) and fails for any of these reasons, the City is entitled to recover under the statute. Other-

wise, the City would be required to try the action against it on the merits, ignoring all other defenses it may have to defeat the action, in order to be made whole under C.C.P. 526(b).

If plaintiffs brought this action in the wrong forum it is perfectly reasonable that they should reimburse the City for the items of expense unnecessarily caused to it. This is so even if they subsequently bring the action in the State court and there be successful. C.C.P. 526(b) places the responsibility of their error in judgment upon them in this regard.

Plaintiffs' arguments on this point must fail for another reason. Contrary to what is said of their Answering Brief, the District Court did not decide that the plaintiffs' action could be maintained in the California courts, or that it was simply a question of the wrong forum. The parties did not argue whether the action would lie in the State court nor the District Court take it upon itself to decide that. It held only that the action was not maintainable in the United States District Court, Judge Halbert's Opinion closing with the observation that the place for the plaintiffs to seek their remedy, if any they had, was in the State court, not the federal court. The legal principle upon which dismissal was based was that of collateral estoppel—a principle which is essentially res judicata, raised in a court other than that which rendered the judgment. This bar is present whether plaintiffs sue in the federal or the State courts. The judgment of the District Court respecting their action was as much "on the merits" as will ever issue from

any court in this litigation. No court will go any further. The language quoted by plaintiffs from *S.M.U.D. v. P.G.&E.,* 20 C.2d 684,[1] is no help to them. The District Court clearly dismissed their action because it had no legal foundation.

B. THE CITY DOES HAVE AN ACTION AGAINST PLAINTIFFS UNDER C.C.P. 526(b) UNDER THE FACTS OF THIS CASE.

1. Plaintiffs label their action as one for "declaratory judgment," and say that therefore, 526(b), which deals with injunctions, does not apply.

The section is applicable to

> "any suit to obtain an injunction . . . enjoining . . . the expenditure of the proceeds of the sale of such bonds or other securities. . . ."

As City already pointed out in its Opening Brief, plaintiffs expressly seek a judgment that the City's deposit of the bond proceeds, in the amount of $2,206,000 with the Clerk of the Superior Court, for payment to Citizens of California, is invalid. Plaintiffs pray for a decree that the deposit, still lodged with the Superior Court, would not constitute a valid payment when distributed to the condemnee (or the plaintiffs, who claim it in the condemnee's stead) under C.C.P. 1252. A determination that City's deposit will not serve as effective payment would compel

[1]"The section establishes as a prerequisite to the recovery of those expenses that the private utility be unsuccessful, thus indicating that its action was without legal foundation." 20 C.2d, at 694.

its return to the City, and would so clearly and effectively enjoin the City's expenditure of the funds for the water system that an injunction forbidding the expenditure in express terms could do no more. Plaintiffs cannot ignore what is in substance and effect an action for injunction by the device of calling it an action for declaratory relief.

2. Plaintiffs also assert that 526(b) only creates a right of recovery if the action is instituted *before* the bonds or securities are sold or delivered. This too is untenable. The section clearly gives the City a right of recovery for unsuccessful actions instituted after the bonds are sold. The statute is applicable if the suit is to enjoin "the expenditure of the proceeds of such bonds," and this obviously assumes an instance where the bonds have been sold. Nor does the fact that the action does not prevent the City's actually taking over the system prevent the application of Section 526(b). If that were intended, it would have been simple enough for the Legislature to say so, and it did not. Instead, the Legislature has said that there is a right of recovery, if "the injunction sought is finally denied," thus making the denial of a permanent injunction the only condition to the City's right of recovery. It surely was apparent to those who drafted and adopted this language that a request for a preliminary injunction might either be granted *or denied* pending the litigation (in which case the City would acquire possession pending the action), but that makes no difference to the City's right of recovery. The language which plaintiffs quote from *S.M.U.D.*

v. P.G.&E. on page 10 of their Brief does not say anything contrary to this. The California Supreme Court referred to litigation which would hamper and interfere with the "development and operation" of a public utility by a public agency. This could include litigation instituted after the acquisition as well as before the acquisition.

3. Plaintiffs also misread the following language in *S.M.U.D. v. P.G.&E.,* to the effect that 526(b) applies:

> "only (to) private utilities and such of those as operate within the area embraced by the public agency." (20 Cal.2d, at 694.)

It does not apply, say the plaintiffs, to those in the business of lending money. The quoted language does not exclude those who are not engaged in the utility business being acquired by the City. Such a construction would make it so simple to avoid the consequences intended by the statute that it would become meaningless. The scope of the statute is clear. It applies to every person or corporation that "owns, controls, or is operating or interested in, a public utility business of the same nature as that" for which the bonds were sold. While Marine Midland may not be a utility itself, the pleadings and record in this action make it plain that it "controls" and is "interested in" public utility water systems. Its complaint alleges that it is a pledgee of all of the stock of Citizens of California (Tr. 3, par. 13) and that Citizens of California owns and operates a water public utility system in, outside and adjacent to the City of North Sacramento

(Tr. 3, par. 11). The pledge gives it control of and makes it legally interested in approximately sixteen other water systems in California which are owned by Citizens of California. (Tr. 78.) The Complaint further alleges that the parent corporation, Citizens Utilities Company of Delaware, is engaged in "the ownership and operation of various public utility systems in ten of the states of the United States" (Tr. 3, par. 9), and that the parent corporation executed in favor of the plaintiffs the Indenture of Mortgage and Deed of Trust to secure the issuance of its bonds (Tr. 3, pars. 12 and 13), which Indenture gave plaintiffs a security interest in the utility properties held by Citizens of Delaware.[2]

4. Plaintiffs' parting shot at the applicability of C.C.P. 526(b) is that it is a penalty statute and therefor must be strictly construed. Section 526(b) merely requires the plaintiff to reimburse the City for attorneys' fees and other expenses forced upon it by the plaintiffs' unsuccessful suit. Requiring such reimbursement for the institution of baseless legal action cannot be called a "penalty." It is not in any sense a punishment. It would be penalty if the state exacted some retribution from such a plaintiff, or made him liable for punitive or exemplary damages, but requiring him to pay the expenses occasioned to the defendant cannot be labeled a penalty.

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[2]The Indenture, by its terms, conveys to plaintiffs "all water systems for the supply of water" owned by Citizens of Delaware, including two water systems in Arizona, three in Idaho, and one in Washington. (Tr. 78.)

> "The test generally underlying most of the cases, however, is that a 'penalty' includes any law compelling a defendant to pay a plaintiff other than what is necessary to compensate him for a legal damage done him by the former." *Miller v. Municipal Court* (1943), 22 C.2d 818, 837.

The decision in *Marshall v. Gote,* 81 C.A. 98, does not say an award of attorneys' fees is a penalty in the sense of exacting from the person responsible more than the damages caused by him. That decision cites *E. Clemens Horst Co. v. Industrial Acc. Comm.,* 184 Cal. 180, which held that an attorneys' fee award under the Workman's Compensation statute does not amount to punitive or exemplary damages, but is compensation in the strict sense for the injury caused. Plaintiffs cite no case and none exist which require that strict construction be given to a statute awarding attorneys' fees to a successful litigant.

POINT II

IN ANY EVENT, DENIAL OF "COSTS" TO DEFENDANT CITY WAS AN ABUSE OF DISCRETION.

Plaintiffs uphold the denial of costs by arguing that the City unduly prolonged the proceedings in moving for summary judgment, which was denied, and by then moving for dismissal, which was granted. The City deemed summary judgment necessary in order to clarify, by affidavits and admissions which are allowable under the summary judgment procedure, the exact rights of plaintiffs in the water system. What

they were and from whom they were derived could not be determined from reading paragraph 13 of the Complaint. Moreover, the City understood the law to be that

> "Whether the pleading be termed a motion to dismiss or for judgment by summary proceedings is of no great importance." *Glenn v. So. Calif. Edison Co.,* 187 F.2d 318, at 320,

and felt that Judge Halbert's denial of summary judgment upon the technical ground that it was the wrong type of motion[3] was not in accord with existing law.

Next the plaintiffs say in connection with City's motion to dismiss that:

> "The Court, not satisfied with the issues raised by the defendants, found it necessary to request 'further briefing' and to allude to specific points as to which it required clarification." (Brief, p. 14.)

The City's motion to dismiss was on the theory that plaintiffs' action was equivalent to a shareholder's suit and that their Complaint had to comply with Rule 23(b) in order for them to sue. Plaintiffs opposing memorandum cited no cases in opposition to this argument, whereas the Court, upon researching the point, found *seven* cases dealing with the pledgee's right to sue. (Tr. 44.) Accordingly, it asked for briefing on those cases, together with subsidiary ques-

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[3]"The Court is of the view that the status of plaintiffs in this action cannot be reached in this proceeding. The decision here made on the motion for summary judgment does not in any way prejudice defendants as to the making of any other appropriate motion." (Tr. 40.)

tions they raised. Failure to cite and discuss those cases was an omission of plaintiffs, not defendant City, because the Court's impression of them was that they gave a pledgee an action of a non-derivative nature.

Plaintiffs' concluding statement under this point, viz:

> "Plainly, the District Court was of the opinion that Plaintiffs herein 'had good reason to think the defendant was liable upon equitable principles.' Bliss v. Anaconda Mining Co., Supra." (Brief, p. 15.)

would not follow from the foregoing points, even if they were true. Judge Halbert gave no indication on these matters, either to the parties, on or outside of the Record. Had this been in the mind of the Judge, he would have said so in denying City's motion for costs, but he did not. (Tr. 81a.)

Both the case cited by the plaintiffs (*Bliss v. Anaconda Copper Mining Co.,* 167 F. 1024) and the case cited by the defendant City (*Chicago Sugar Co. v. American Sugar Co.,* 176 F.2d 1) agree that the Court has the power to deny costs to a successful defendant if the plaintiff brought the action in good faith, and it involved issues as to which the law was in doubt, or not thoroughly settled. But in this case Judge Halbert refrained from making any expression regarding the good faith of the plaintiffs,[4] and nowhere does

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[4]In fact, he noted the seemingly endless attacks on the condemnation judgment persisted in by Citizens of California in the State Courts. (Tr. 5.)

his Opinion suggest that the questions involved are not well settled or that the applicable law was in doubt. Such exceptions as there are do not apply here.

> "The prevailing party is, however, prima facie entitled to costs, and it is incumbent on the unsuccessful party to show circumstances sufficient to overcome the presumption." *In Re Northern Indiana Oil Co.* (7th Cir., 1951), 192 F.2d 139, 142.

Plaintiffs have not shown exceptional circumstances. They made no attempt to show any when the City moved to amend the judgment re costs, filing nothing in opposition thereto. Judge Halbert referred to none, either in his Memorandum granting the motion to dismiss (Tr. 47-54) or in his Order denying the motion to amend the judgment re costs. (Tr. 81a.) None are in fact present.

The denial of costs in this instance must be additionally considered in the light of C.C.P. 526b, a state statute giving the City an absolute right of recovery of its costs. There was no reason for the District Court to refuse the City the benefit of its provisions. *Sioux County v. National Surety Co.* (1928), 276 U.S. 238, at 243, 72 L.ed. 547; *Cohen v. Beneficial Industrial Loan Corp.* (1948), 337 U.S. 541, 93 L.ed. 1528.

CONCLUSION

The District Court should be directed to amend the Judgment of April 26, 1963, to tax costs upon plaintiffs, and to permit defendant City to file its counterclaim against plaintiffs under C.C.P. 526b.

Dated, February 7, 1964.

Respectfully submitted,
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Martin McDonough,
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No. 18,905

United States Court of Appeals
For the Ninth Circuit

Kansas City Fire and Marine Insurance Company, a corporation,
Appellant,
vs.
Wayne A. Clark, The Montana Power Company, a corporation, Lew Chevrolet Company, a corporation, and Clarence G. Madsen,
Appellees.

OPENING BRIEF OF
KANSAS CITY FIRE AND MARINE INSURANCE COMPANY,
Plaintiff and Appellant, on Its Appeal From
Judgment in Favor of Defendants.

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No. 18,905

United States Court of Appeals
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Kansas City Fire and Marine Insurance Company, a corporation,

Appellant,

vs.

Wayne A. Clark, The Montana Power Company, a corporation, Lew Chevrolet Company, a corporation, and Clarence G. Madsen,

Appellees.

OPENING BRIEF OF KANSAS CITY FIRE AND MARINE INSURANCE COMPANY, Plaintiff and Appellant, on Its Appeal From Judgment in Favor of Defendants.

A. Statement of the pleadings and facts disclosing the basis of jurisdiction.

This is an action for declaratory relief involving diverse citizenship and a matter in controversy exceeding the sum of $10,000.00 exclusive of interest and costs. (Complaint, paragraphs I and II; Transcript of Record, Vol. I, pages 1-2.)

The statutory provision believed to sustain the jurisdiction is 28 U.S.C.A., sec. 1332.

The statutory provision believed to sustain the jurisdiction of the Court of Appeals is 28 U.S.C.A., sec. 1291.

B. Statement of the case.

Wayne Clark was a private pilot with a limited certificate. He desired instruction in order to obtain a commercial license. For this purpose he arranged with Al Forhart for a course of training and paid $1,500 on account of tuition charge. (T.R. 39:16-32.)[1]

Clark's occupation was sales manager for defendant Lew Chevrolet Company located at Billings, Montana. He received a telephone call from Red Lodge, Montana. The substance of the call was that a Mr. A. M. Sheffield had wrecked his automobile and wanted to buy a Chevrolet but none was available in Red Lodge. (T.R. 40:15-19.)

Clark informed Forhart that he had an opportunity to go to Red Lodge and that he would like to get a little flying time. Forhart agreed. (R. 28:2-10.) Otherwise, Clark would have used other means of transportation. (R. 27-8.) Nothing was said about transporting passengers on the return trip. (R. 28:8-16.)

Clark was accompanied on the flight by Clarence Madsen, also an employee of Lew Chevrolet Co. (T.R. 25:13-17.) The distance traveled was sixty miles. On landing in Red Lodge he took on board Mr. Sheffield and his son Darrell, with the result that the plane was carrying four persons making a load of 866 pounds. This was within

[1]References to Volume One of the Transcript of Record containing the pleadings, findings, opinion and judgment will be identified by the initials T.R. References to Volume Two containing the transcript of the trial will be identified by the initial R.

34 pounds of its maximum useful load. (R. 29-30.) In the course of take-off the plane struck power wires belonging to the Montana Power Co. and crashed. (T.R. 26:15-18.) The Sheffields made a claim for personal injuries against Clark and his employer, Lew Chevrolet Co. Madsen, Clark's co-employee, made a claim against Clark for personal injuries. Montana Power Co. made a claim for damage to its property.

Forhart carried insurance issued by the plaintiff. The policy contained provisions amplifying the identity of those who were insured by it and also stipulations as to permitted uses.

The Insurance Company commenced suit for a declaratory judgment that Clark was not insured; that the use of the plane by Clark was not one which was permitted under the policy and that the company was not liable to pay any judgment that might be rendered against Clark or the Chevrolet Company.

The learned District Judge decided that Clark and his employer, Lew Chevrolet Co., were insureds under the policy; that the insurance company was obligated to defend and to pay any judgment based on the claims of the Sheffields, Madsen, and Montana Power Co. against Clark or Lew Chevrolet Co., or both. Judgment was entered accordingly.

Thus, not only is Clark held to be an insured; but his employer, whose only basis of liability is that Clark was acting in the scope of his employment, is also an insured; and finally, the insurance company is held liable for the injuries of Madsen, a co-employee of Clark. From this

extraordinary outcome the insurance company has appealed.

C. Statement of questions involved and the manner in which they are raised.

The questions involved are the following:

(1) Were the defendants or any of them within the category of "insured" as that term is defined in the policy of insurance?

(2) Under the terms of the policy was the use of the airplane at the time of the crash one which was permitted and under the circumstances of the flight was Clark a permitted pilot?

The manner in which the foregoing questions are raised is by objection to the findings of fact, conclusions of law and judgment, and the contention of appellant insurance company that the foregoing questions should have been decided in its favor and judgment rendered accordingly.

D. Specification of errors.

(1) Error in failing to decide that none of the defendants is an insured under the policy involved in this action.

(2) Error in failing to decide that at the time of the occurrence which resulted in injuries and damage to third parties, defendant Clark was operating the aircraft under the terms of a training program which provided remuneration to Forhart, the insured, and therefore neither Clark nor his employer, Lew Chevrolet, is an insured.

(3) Error in failing to decide that appellant is not liable for the conduct of Clark in piloting said aircraft at the time of said occurrence.

(4) Error in failing to decide that at the time of said occurrence said aircraft was being used for a purpose not permitted by the terms of said policy.

(5) Error in failing to decide that at said time said aircraft was being operated by a pilot not permitted under said policy.

(6) Error in failing to decide that at said time said aircraft was being operated for the business of Clark and Lew Chevrolet Co.

(7) Error in failing to decide that at said time the operation of said aircraft was not under the direct supervision and control of a properly certificated instruction pilot and that Forhart, the instructor, had no knowledge concerning the business purpose of the flight or that Clark was carrying three passengers.

(8) Error in finding that Clark was a pilot contemplated and authorized by General Endorsement No. 3 and/or item 7 of the Declarations as set forth in Part A of Endorsement No. 3. (T.R. 65-6.)

(9) Error in finding that the use which Clark was making of the aircraft was a use contemplated in Item 6 of the Declarations in the policy when construed with paragraph A of Endorsement No. 3. (T.R. 66:2-3.)

(10) Error in finding that the use and operation of said aircraft was not under the terms of a training program which provided remuneration to Forhart; and that Clark was not engaged in any training program contemplated by the provisions of the policy. (T.R. 66:11-19.)

(11) Error in finding that that the time of the crash Clark was under the direct supervision and control of Forhart. (T.R. 61:19-20.)

(12) Error in finding that plaintiff has admitted coverage for Forhart. (T.R. 62:20-21.)

(13) Error in failing to find that none of the defendants was a person insured under said policy and in failing to find that at the time of said occurrence the use of the airplane was one which was not permitted by the policy; and that at said time the airplane was being used for business and was operated by a person not permitted by the policy.

(14) Error in concluding that Clark and any person or organization legally responsible for his use and operation of the aircraft were "insureds" under the terms of said policy. (T.R. 67:14-20.)

(15) Error in concluding that under the terms of said policy plaintiff is obligated to furnish to Clark and Lew Chevrolet Co. a legal defense to the actions filed against them by A. M. Sheffield, Darrell Sheffield, Clarence G. Madsen and Montana Power Co. (T.R. 67:21-5.)

(16) Error in concluding that up to the limits of the policy plaintiff is obligated to pay any judgment that may be rendered in favor of A. M. Sheffield, Darrell Sheffield, Clarence G. Madsen and Montana Power Co. against Clark and Lew Chevrolet Co. (T.R. 67:26-32.)

(17) Error in concluding that defendants are entitled to judgment.

(18) Error in failing to conclude that plaintiff is entitled to judgment.

(19) Error in granting judgment in favor of defendants as set forth in the judgment on file herein. (T.R. 69-70.)

(20) Error in failing to give judgment in favor of plaintiff.

E. Summary of Argument.

(1) The policy of insurance contains a "Definition of Insured". This is extended so as to include others than the "Named Insured" (Forhart) but the provision does not apply to "any person operating the aircraft under . . . any training program which provides any remuneration to the Named Insured for the use of said aircraft". Clark was operating the aircraft under such a training program. Therefore, he is not covered and the insurance company was not obligated to defend him or his employer, Lew Chevrolet Co., against the claims based on Clark's alleged negligent conduct.

This proposition suffices to dispose of the case. It entitles the insurance company to the declaratory relief which it seeks and requires a reversal of the judgment of the District Court.

(2) Furthermore, assuming that by any stretch of reasoning Clark could be regarded as an insured, his flight was not under the direct supervision and control of his instructor and therefore, his use of aircraft at the time of the occurrence was not one which was permitted by the policy, but on the contrary, was a use to which the policy by its express provisions did not apply.

Thus, for two independent reasons the insurance company is not obligated to defendant Clark, or his employer, Lew Chevrolet Co., nor to pay any claim asserted against them.

ARGUMENT

1. This aircraft insurance policy contains separate and independent provisions as to (1) the identity of those who are included in the category of the term "insured"; and (2) the uses of the aircraft which are permitted as the basis of liability. These two aspects must not be confused.

Paragraph I of the "Insuring Agreements" sets forth the obligation of the company to pay on behalf of the "Insured" all sums which the Insured shall be legally obligated to pay as damage because of bodily injury. The policy (Par. III of Insuring Agreements) contains a definition of the word "Insured" and states that "the provisions of this paragraph do not apply:

* * * * * * *

> (d) To any person operating the aircraft under the terms of any rental agreement or training program which provides any remuneration to the Named Insured for the use of said aircraft."

Hence, the first inquiry concerns the identity of the persons who come within the class of "insured".

But the identity of the insured is not the only aspect to be considered. The circumstances of the flight are also important. For this purpose the applicant informed the company as to the kind of flight and the identity of the pilots to be permitted. This information was incorporated into the policy by checking certain items in the Declarations and by attaching a printed form of endorsement (No. 3) containing a typewritten statement of permitted uses pertinent to student instruction. The policy further provides that it "does not apply" to an occurrence or to a pilot not stipulated.

The two concepts—the identity of the insured and the circumstances of the flight—are separate and independent of each other. They need not be similar in content or meaning. The insurance company may be willing to enlarge the term "insured" in certain respects but on the other hand, it may place other and different limitations on the use of the aircraft. If this distinction is not kept in mind, hopeless confusion in construing the contract must necessarily follow.

This distinction is explained in *Farm Bureau Ins. Co. v. Daniel*, 104 F. 2d 477 (4th Circ.) The Farm Bureau sought declaratory judgment that its policy did not cover claims for death resulting from the negligent operation of the insured Ford truck. From an adverse judgment in the District Court the insurance company appealed. The Court of Appeals reversed.

The policy—as in the case at bar—provided that it should apply only to accidents which should occur while the truck was being used for the purposes stated in the declarations. (p. 478.) The declarations identified these purposes as "hauling auto parts, building material and farm produce".(id.)

The Ford was driven to the scene of an automobile wreck and certain articles taken from the wreck were loaded on the Ford. On the return trip two men were killed as the result of the driver's negligence. (pp. 478-9.)

Thus, the use of the Ford was one which was not permitted by the insurance policy.

But the contention—which prevailed in the District Court—was advanced "that the truck was covered at the

time of the accident by reason of the definition of the insured contained in paragraph III of the insuring agreements of the policy''. (p. 479.) The Court of Appeals quotes ''this so-called omnibus clause'' which extended protection ''not only to the named insured but also to any person while using the automobile and any person or organization legally responsible for the use thereof, provided that the declared and actual use of the automobile is 'pleasure and business' or 'commercial', each as defined herein, and provided further that the actual use was with the permission of the named insured''. (id.)

The court rejected this contention and reversed, holding:

> The primary function of the omnibus clause was not to define the purposes to which the car was to be put, but to state the conditions under which the coverage would be extended to include not only the named insured, but also other persons while using the car with the permission of the insured.
>
> (p. 479.)

Incidentally, the court also held that ''the terms of the policy were not ambiguous, and therefore we have no occasion to consider the conflicting testimony, which was taken in the District Court, as to the purposes for which the policy was issued''. (id.)

To the same effect is *Standard Surety Co. v. Maryland Cas. Co.*, 119 N.Y. Supp. 2d 795, where the Appellate Division held:

> The exclusion clause is concerned with the hazards to which the policy did not apply and it should be interpreted in terms of the injuries to be excluded,

> not in terms of the persons who are to be indemnified. This latter consideration is the concern of policy clause entitled "Definition of 'Insured'."
>
> (p. 799.)

The instances in which the courts have been called upon to preserve the distinction between the "insured" clause and the "use" clause are infrequent. The reason may be that this distinction has not been controverted until the point arose in *Petro v. Ohio Cas. Co.*, 95 F. Supp. 59 (S.D. Cal.) on which the decision in the case at bar is based. Neither the opinion in *Petro* nor that at bar cites any case in support of the theory that the two clauses must be construed together. The decisions will be discussed below.

2. Clark was operating the aircraft under the terms of a training program which provided remuneration to Forhart for the use of the aircraft.

The "Named Insured" in this policy is, of course, Forhart who purchased the insurance. But it is provided that the category of insured may be extended to others. (Insuring Agreements, paragraph III.) This is an enlargement as the result of which persons may be covered even though they are strangers to the contract. But there is a limit to this indulgence. It does not apply to pilots under a training program.

"Training program" means a course of training. The person engaged therein is a trainee. Training is defined as

> An act or process, by means of drill, practice, etc., of becoming proficient in some art, or prepared for a test or contest, especially of physical skill or prowess;

> the systematic development of one's strength and ability; practice; exercise . . .
>
> Webster's New International Dictionary.

Defendant's exhibit No. 8 is a statement signed by Clark. It contains the following:

> Under the instruction flight training mentioned above by saying that the solo flight training was under the direction of the instructor. I mean that the instructor gave instructions and direction before the take off.

Clark's use of the word "training" is significant. The word is one used in common speech.

To be sure, when the insurance company served requests for admissions Clark in his response stated:

> I was never engaged in any "training program" with Al Forhart, and there was never any "training program" with him, as I understand the words "training program" to mean.
>
> (T.R. 39:14-16.)

Of course, Clark's understanding of the meaning of the words is not determinative. The remainder of his response demonstrates that he was taking a course of instruction and paying for it. He says:

> I entered into an agreement with Al Forhart for instruction leading to my qualifying for a commercial license, which contemplated some hours of dual time flying with Forhart, and many hours of solo time flying without Forhart, until I accumulated enough of both dual hours, and solo hours, to procure my commercial license. Prior to July 26, 1960, I had

> paid to Al Forhart of the Forhart Flying Service the sum of $1,500 for the foregoing purpose.
> (T.R. 39:18-25.)

This is an apt description of a training program.

There is nothing technical about these words. They are the kind of words which are customarily used in ordinary expression of ideas. The dictionary is the most reliable source of information as to their meaning. As the court held in *Mass. Mut. Life Ins. Co. v. Pistolesi*, 160 F. 2d 668 (9th), the words of all insurance policies are construed in their ordinary and popular sense and the opinion relies on the dictionary definitions of the words of the policy before the court. (p. 669.) That was a California case. But the principle is universal.

A dictionary definition was quoted in a case involving the definition of insured in an aircraft policy—*Insurance Co. of North America v. General Aviation Supply Co.*, 283 F. 2d 590 (C.A. 8th). There in enlarging the scope of the definition of "insured" the policy provided that the insurance with respect to any person other than the named insured does not apply to ". . . any aviation sales or service or repair organization". This is similar to subparagraph (c) of paragraph III of Forhart's policy. The question in the case in the eighth circuit was whether the foregoing description applied to a person who "sells aircraft supplies and equipment" but does not engage in the business of the sale of aircraft, or service or repair of aircraft. The District Court held that the sale of aircraft supplies and equipment did not come within the prohibited activity. The opinion of the Court of Appeals quotes the

dictionary definition of "aviation". It held that the term "aviation sales organization" did not describe the business of the plaintiff in the action who sought to establish coverage.

The learned District Judge in the case at bar ruled that "Standard dictionaries give no aid in" the "application" of the words "training program". (T.R. 51.) Yet he cited the General Aviation Supply case (footnote 7, T.R. 53) which—as we have seen—indicates otherwise.

Judge Jameson suggests that the insurance company was delinquent because it "did not offer any evidence with respect to the meaning of the words 'training program' as used in aircraft policies". (T.R. 52.) The answer is that no such evidence was necessary and that a judge (in the absence of a jury) would be justified in assuring counsel that he was as capable of comprehending the meaning of the term as any expert in philology.

The fundamental fallacy of the decision is the failure to recognize the different functions served by the omnibus clause defining the scope of those insured and the use clause limiting the uses of the aircraft to which the policy applies. (See section 1, supra.) In this respect the decision approves and follows *Petro v. Ohio Cas. Co.,* 95 F. Supp. 59, although Judge Jameson concedes that the omnibus clause in *Petro* differs from that at bar. (See footnote 10 to opinion, T.R. 54).[2]

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[2]The omnibus clause in *Petro* did not contain the words "training program". It provided that "insured" did not apply to a "student pilot". Brown, the pilot who flew the plane, held a private license and was taking instructions in order to obtain a commercial license.

Judge Yankwich held that "student pilot" was "clearly intended to apply to persons who take their first instructions before they secure any license which entitles them to operate a plane". (p. 63.) This ended the case. Brown was an insured and the Ohio Casualty Co. was liable for his negligence. No contention was made by the Ohio Co. that the use of the plane was not within the permissive clause of the policy.

Hence, there was no occasion for comparing the "insured" clause with the "use" clause and the comments of Judge Yankwich on this subject may be regarded as dictum. But Judge Jameson adopts this dictum and applies it to the case at bar, thus failing to realize that the two clauses serve different functions and that an insurance company may be willing to permit the operation of the plane by specified persons and to protect its customer accordingly, but on the other hand may not be willing to extend the category of "insured" to those other persons. There is no reason why an insurance company cannot say in its policy: "We will pay any liability on the part of the person who bought and paid for this insurance even though a trainee under program is operating the plane, but we will not defend the trainee or pay any judgment against him on account of his negligence".

Judge Jameson compares the two clauses in the policy at bar and because they do not use identical terms he emasculates the provision which refuses to extend the omnibus clause to a pilot under a training program. (T.R. 53.)

Judge Jameson points to the provision in the Declarations which permits use of the plane for "student instruc-

tion." He concludes that if the insurance company "intended to except Forhart's students" from the category of "insured", it "should have referred to 'student instruction' ". (T.R. 53.)

There is ample reason for not using the words "student instruction" in the omnibus clause. In *Petro* (95 F. Supp. 59) Judge Yankwich had decided that a pilot who is receiving instruction to improve his status is not a student.[3] The advisable course was to avoid a repetition of this result. The words "training program" accomplished this. Furthermore, Endorsement No. 3 (permitting use by pilots under instruction) expressly provides:

> Nothing herein contained shall vary, alter, waive or extend any of the terms, representations, conditions or agreements of the Policy other than as above stated.

Hence, the use clause cannot impair the effect of the omnibus clause.

Judge Jameson suggests (T.R. 52-3) that "training program" as used in the policy could mean either "a course of instruction for an individual student" or "a formal instruction program sponsored by a federal or state agency".

Forhart's planes could not possibly be used in connection with an official program of instruction. Except for the military service the only civilian activity involves the Civil Air Patrol. (36 U.S.C.A. § 201, et seq.) This is a volunteer civilian auxiliary of the Air Force and the Sec-

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[3]This ruling is open to doubt. The word "student" is not limited to a novice. No matter how far advanced a person may be, he is still a student when receiving instruction; e.g. a graduate student.

retary of Defense may provide government property, including aircraft and airports, for this purpose and provide training aids. (10 U.S.C.A. § 9441.)

Obviously, Forhart was not a participant in this activity and there could be no conceivable basis for excluding it from the scope of the omnibus clause.

Judge Jameson also refers to the "Civilian Pilot Training Program" involved in *LeBlanc v. Am. Ins. Co.*, 155 F. 2d 969 (5th Cir.) and suggests that such a program might be the one contemplated in the policy at bar. (T.R. 52-3.) The answer is that this was a Louisiana institution created by a 1930 act of the state legislature which no longer exists.

However, even if there were two different kinds of training programs, both would be excluded. The insured clause is not applicable to *any* person engaged in *any* training program. In *Lambert v. N.E. Fire Ins. Co.*, 148 Me. 60, 90 Atl. 2d 451 an automobile policy provided:

> This policy does not apply; . . . (h) under coverages D, E, F, G, H, I and J while the automobile is subject to any bailment lease, conditional sale, mortgage or other encumbrance not specifically declared and described in this policy.
>
> (p. 453.)

Lambert contended that this provision concerned only encumbrances in existence at the time of the issuance of the policy and not to one placed on the vehicle after issuance. This contention was rejected in the trial court. A non-suit was granted. The Supreme Judicial Court affirmed. The decision is stated in the syllabus as follows:

> (5) In construing combination automobile insurance policy, providing that "policy does not apply; * * * while automobile is subject to any * * * mortgage or other encumbrance not specifically declared or described in this policy", word "while" was an adverbial modifier meaning "as long as", and word "*any*" meant "*all or every*", and where owner of truck created a valid, subsisting encumbrance on truck after issuance of policy, insurer was not liable for destruction of the truck by fire. (Italics supplied.)
>
> (p. 451.)

According to the decision below the exclusion applies to neither of the two kinds of hypothetical training programs. In other words, "any" means "none". The rule of strict construction against insurance companies does not go to such an extremity.

Judge Jameson says: "Most of plaintiff's contentions boil down to one, i.e., that only Forhart was insured by the policy. If in fact this was intended, it would have been very simple to insert the provision, 'Al Forhart (named as Al Forhart Flying Service) is the only person insured by this policy', or words to that effect." (T.R. 54.)

In the first place this is not a correct analysis of the policy and the company advances no such contention. A casual student—with or without pay—would not be engaged in a "program". He would be an insured and if he made a flight under an instructor's supervision, the flight would be a permitted use. Likewise, even in the instance of a course of instruction if no remuneration is paid, the student would be an insured.

Also, if either Forhart or any of the pilots above mentioned were at the controls, an occupant of the plane while in flight or after landing would be an insured and covered in the event that his negligence was the cause of injury to persons or damage to property.

Furthermore, the effect of the policy was for Forhart to decide. The omnibus clause gave wide latitude to the word "insured". If Forhart chose to limit the use of the plane, that was his privilege. Strangers to the contract have no right to complain.

The testimony shows that Forhart's purpose was to protect himself. He got what he wanted.

3. **The theory that every conceivable doubt must be resolved against the insurance company has no application in the case of a third party who seeks to insinuate himself into the category of those insured under the policy.**

As the foregoing argument demonstrates, the words "training program" are clear and unambiguous. They adequately describe Clark's activity. But let us assume the presence of some aspect of uncertainty so that if Forhart's financial interest were involved, a case would be presented for interpretation in his favor. This point is not essential to the decision in this case but the subject is one of possible accademic interest.

It makes no difference to Forhart whether or not Clark is held to be an insured. In Montana there is no vicarious liability on the part of the owner of an aircraft. The basis of the theory which calls for construction favorable to the policyholder is that the company adopts a printed form and its customer must take it or leave it.

But a prospective participant in a future training program is not a party to the contract. There is no obligation on the part of the policyholder or the company to protect a stranger's interest. He pays no premium. Consequently, he should be required to show that on the basis of a fair and reasonable analysis of the policy, he is included as an insured. Only in that case should he enjoy free coverage.

The situation would be different if the named insured is subjected to a claim for damages on the part of a third person. There it would be to the interest of the policyholder that the contract be held to apply to the circumstances under which the damage is inflicted. Hence, such a third party claimant may be entitled to invoke the rule of liberal construction.

But the case at bar is altogether different. There is no evidence that Forhart was seeking protection for others than himself. He wanted complete coverage for himself. That is what he received.

4. A flight involving a landing at a distant airport and an attempt to take off with three passengers without the knowledge of the instructor is not under his direct supervision and control.

It should first be noted that with respect to the permissive use clause this is not a "take it or leave it" situation. It is not a case in which the insured is not permitted "to have a voice in the drawing of his own contract". (*Montana Auto. v. British Underwriters,* 72 Mont. 69, 232 P. 198, 200.) On the contrary, the contemplated uses were the subject of bargaining before the risk was accepted. (See exchange of telegrams, exhibits A to

D and F, T.R. 29-32; 36; also testimony of Lynch (R. 9:18-20; 11:22-7; 12:20-26; 15-16); also Forhart's application (T.R. 35) containing a schedule of "Purposes for which aircraft will be used".) The use clause was specially prepared to accommodate Forhart's requirements. (See Declarations, item 6 and item 7 of which endorsement number 3 is a part.)

In the typical case the policy is construed against the insurance company because the insured must accept a printed form. In the case at bar the reason for this rule does not exist. Hence, the rule cannot apply.

But no matter how far a court may lean in an effort to bring Clark's flight within the scope of the permitted use, by no stretch of reasoning can it be regarded as under Forhart's "direct supervision and control".

The record on the subject of Forhart's connection with the flight appears in Clark's testimony and his responses to requests for admission. He testified:

> Q. In connection with taking that trip, you called Mr. Forhart and asked him if the plane was available?
>
> A. Yes.
>
> (R. 27:22-4.)

* * * * * * *

> Q. Did you advise Mr. Forhart what you had planned to do at all in Red Lodge?
>
> A. I don't recall going into detail on that.
>
> Q. Did you advise him that you were going up there for any specific purpose other than that of getting time in the aircraft?
>
> A. As I recall I told him I had an opportunity to go to Red Lodge and would like to get a little flying time in if the plane was available.

Q. But you did not advise him what, if anything, you were going to do in Red Lodge?

A. No.

Q. You did not advise him you intended to fly a passenger or any particular number of passengers back from Red Lodge?

A. I did not know it myself at that time.

(R. 28:2-16.)

* * * * * * *

Q. Had you ever received any instruction from your instructor either verbally or in flight for taking an aircraft off with this load under the weather conditions and air density that were evident at that time?

A. When I called Mr. Forhart to get permission to use the plane there was a little discussion like it says in the statement about that.

Q. Well, did you receive any instruction from him at all, or any advice from him at all with respect to an operation of an aircraft at this height with this load?

A. I did not say anything about the load, of course, because I did not know how many people I was going to carry. I did not know myself. But he did mention about that the air was thinner at that altitude, to be careful of that.

(R. 31:21-32:7.)

Clark's admissions contain the following:

On July 26, 1960, in the afternoon I called Al Forhart and told him that I wanted to get in some more flying time and that I had in mind going to Red Lodge. He said that the Cessna was available and would be ready.

The conversation about Red Lodge was very brief. I knew the altitude there and had landed on that field

> before. He didn't say anything about that. The only thing he had to say was that the weather was okay, and that was apparent.
>
> (T.R. 40:6-14.)

The words "direct supervision and control" may require that the aircraft remain under continuous observation of the instructor. Otherwise, how can the latter have any idea as to the manner in which the craft is being flown? If it sufficed for the trainee to notify the instructor of his destination and obtain permission to fly, then a flight of six hundred miles instead of sixty—here involved—would be permissible. Considering the speed of aircraft there would be no limit to the length of the flight.

Nor can mere permission on the part of Forhart suffice. The policy does not make him the arbiter of what "direct supervision and control" means. He cannot dispense with its provisions and create a situation of supervision and control by authorizing Clark to use the plane and then go about his business.

But it is unnecessary to draw so fine a line in order to demonstrate that the use here was not within the permissive clause. Here there is one determinative fact—Forhart did not have the slightest intimation that Clark would endeavor to fly with three passengers thus involving almost the maximum load capacity of the plane. How could Forhart supervise and control an operation of which he was utterly ignorant?[4] The determinative issue is not whether Clark was competent to take off with three pas-

---

[4]Charles Lynch, the operator of a flying service, whose company sold the plane to Forhart and who procured the issuance of this policy testified that "it is generally considered in the industry that when a pilot obtains permission from his instructor to fly solo that he is under the supervision of the instructor when

sengers—something he had never done before (R. 28:21-5)—nor whether Forhart would have approved the flight if he had been apprised. The question is: Did Forhart have direct supervision and control of the flight? Clearly, the answer is that he did not.

The fact that the Sheffields and Madsen have sued for personal injuries and that Lew Chevrolet Co. seeks to hold the insurance company responsible demonstrates that Clark is being charged with negligence. If Forhart had been in control of the flight he would have had an opportunity to avoid the catastrophe. This was the reason for the provision in the policy requiring direct supervision and control. The insurance company stipulated for this protection and on that basis calculated the element of risk and charged a premium accordingly. There is no conceivable ground for imposing on the insurance company the consequences of Clark's incompetence so as to relieve him and the Chevrolet Co. of liability. This was not what Forhart bargained for nor what the policy provides.

It may be—as the opinion of the trial judge states (T.R. 43)—that "it is important, in order to obtain a commercial license, that the pilot experience flying with a plane-load of passengers so that he may establish ability in that respect". But it is infinitely more important to the security of such passengers, who occupy the status of guinea pigs, that the instructor be on hand to provide the necessary counsel as to the technique of take-off under the prevailing conditions of weather, turbulence and load-capacity.

---

he gets permission to take the aircraft alone" (R. 19:1-6). Assuming that the attitude of the "industry" could be binding on the courts, this is a far cry from taking on three passengers at a distant airport.

Witness Lynch testified:

> Q. And it is important in order to obtain a commercial license that the pilot experience carrying a full load of passengers, isn't it?
>
> A. Yes, the F. A. recommends that under the supervision of the instructor that that ability be established.
>
> (R. 18:22-26)

Assuming the existence of such a recommendation, it includes the requirement of "supervision of the instructor". But regardless of what the Federal Agency may recommend the determinative factor here is what the insurance policy requires.

With due deference we submit that the decision below leads to an absurdity. For the purpose of bringing Clark's flight into the permitted area the District Court obliterates its business aspect and holds that Clark was engaged in an instructional venture under Forhart's direct supervision and control. But on the other hand, for the purpose of imposing on the insurance company the liability of Lew Chevrolet Co. to pay for the Sheffields' injuries, the District Court holds that Clark was making a business flight and was acting within the scope of his employment by Lew Chevrolet Co.

From the argument above set forth the conclusion inevitably follows that Clark's use of the plane was not within those set forth in the declarations and therefore, it was squarely within the provision that

> "This policy does not apply: . . . 2. To any occurrence or to any loss or damage occurring while the aircraft is operated, while in flight, by other than the pilot or pilots set forth under item 7 of the Declarations."

5. Clark was engaged in a business flight—an activity which was permitted solely to Forhart.

Endorsement number 3 (incorporated into item 7 of the Declarations) authorizes flight under direct supervision and control of the instructor. It also permits Forhart to operate the plane for purposes of business. It does not permit a student—whether elementary or advanced—to use the plane for business purposes.

The learned District Judge holds that Clark's flight was for the purpose of instruction and had "as its incident" a "business purpose". (T.R. 49.) The answer is that the motivating reason for the flight was to solicit the sale of an automobile. The opinion below concedes that "Clark would have made the 60 mile trip to Red Lodge in any event" and that "the trip could easily have been made by automobile". (T.R. 48.) Hence, Clark's purpose to "put in some flight time" (op. T.R. 49) was incidental, just as a desire for exercise would have been incidental if he had walked to Red Lodge.

6. Such adjustment as the insurance company has chosen to make with its named insured cannot bar it from relying on the non-permitted use of the plane.

Not content with their effort to obtain gratuitous inclusion as "insured" under Forhart's policy, the Lew Chevrolet Co., Clark and the other defendants endeavor to participate in the indulgences which—they assert—the insurance company has granted to its paying customer in accepting coverage for him and dismissing him with prejudice. (Op. T.R. 55)[6]

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[6]Judge Jameson expressed doubt as to the validity of this contention but did not decide the point. (T.R. 55-6)

There are several answers to this contention. First: The company had the right to make such adjustment with Forhart—whether for goodwill or other reasons—as it saw fit. Outsiders cannot demand similar concessions. The defendants were not parties to this transaction. Assuming that there was a waiver, it would not be available to them.

In *Gerard v. Sander,* 110 Mont. 71, 103 P. 2d 314, the court said:

> "Waiver" has been well defined and this court in *Northwestern F & M. Ins. Co. v. Pollard,* 74 Mont. 142, 238 P. 594, 596, sets out the essential elements. Waiver requires two parties—one party waiving the right, and another receiving the benefit of such waiver. "Waiver must be manifested in some unequivocal manner, and to operate as such it must in all cases be intentional. There can be no waiver unless so intended by one party and so understood by the other." *Northwestern F & M. Ins. Co. v. Pollard,* supra; see, also, *Mundt v. Mallon,* 106 Mont. 242, 76 P. 2d 326.
>
> (p. 318)

Second: Dismissal of the suit as against Forhart merely bars the insurance company from seeking declaratory relief against him. It does not constitute a determination of any liability on the part of the company.

Third: The sole interest of Forhart arising out of this occurrence involved the damage to his plane. There is no vicarious liability in Montana on the part of an owner. Therefore, Forhart was not responsible for the personal injuries resulting from the crash. As to the material

damage to the plane, the insurance company was liable even though it was being operated for a non-permitted use. The plane was mortgaged to a bank which was the loss payee under the policy. Under Endorsement Number 1 (Breach of Warranty Endorsement) the bank was entitled to collect substantially the entire amount of the insurance regardless of any "breach" of "the policy provisions". Hence, the plane was covered and the company had no alternative but to accept coverage and the dismissal as to Forhart had no legal significance.

7. Conclusion.

It is respectfully submitted that the judgment should be reversed.

Dated: December 18, 1963.

Respectfully submitted,

David Livingston,

Attorney for Appellant.

Certificate

I certify that, in connection with the preparation of this brief, I have examined rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

David Livingston,

Attorney for Appellant.

(Appendix Follows)

Appendix.

Appendix

Schedule of Exhibits:	Reference to Record	
Exhibit No. 1—Policy	T.R. Vol. 1	p. 21
Exhibit No. 2—Telegram	T.R. Vol. 1	pp. 21, 29
Exhibit No. 3—Telegram	T.R. Vol. 1	pp. 22, 30
Exhibit No. 4—Telegram	T.R. Vol. 1	pp. 22, 31
Exhibit No. 5—Telegram	T.R. Vol. 1	pp. 22, 32
Exhibit No. 6—Pilot rating application	T.R. Vol. 1	pp. 22, 33-5
Exhibit No. 7—Telegram	T.R. Vol. 1	pp. 22, 36
Exhibit No. 8—Statement of Clark	T.R. Vol. 1	p. 22
Exhibit No. 9—Copy of letter	T.R. Vol. 1	p. 22
Exhibit No. 10—Response of defendant Madsen	T.R. Vol. 2	pp. 3-4

COMBINATION AIRCRAFT POLICY

No. AC - 6611

THIS HEREBY CERTIFIES THAT THIS IS A TRUE AND CORRECT COPY OF POLICY

KANSAS CITY FIRE & MARINE Insurance Company

KANSAS CITY, MISSOURI

301 WEST 11TH STREET

Issued Through AMERICAN AVIATION UNDERWRITERS

P. O. BOX 1660, HOUSTON 1, TEXAS • 234 BUSH STREET, SAN FRANCISCO 4, CALIF.
3540 WILSHIRE BLVD., LOS ANGELES 5, CALIF.

DECLARATIONS

Item 1. Name of Insured and Address: AL FORHART FLYING SERVICE
938 CUSTER AVENUE
BILLINGS, MONTANA

Item 2. The policy period shall be from APRIL 3, 1960 to APRIL 3, 1961
12:01 A. M. Standard Time at the address of the Named Insured as stated herein.

Item 3. The aircraft will be principally hangared in the above town and state, unless otherwise stated herein:* ____

Item 4. The insurance afforded is only with respect to such and so many of the following coverages as are indicated by specific premium charge or charges. The limit of the Company's liability against each such coverage shall be as stated herein, subject to all of the terms of this Policy having reference thereto. When two or more aircraft are insured hereunder, the terms of this Policy shall apply separately to each.

	PREMIUMS	LIMITS OF LIABILITY		COVERAGES
A.	$ 66.24	$ 50,000 Each Person;	$ 100,000 Each Occurrence	Bodily Injury Liability EXcluding Passengers
B.	$ 250.00	$ 50,000 Each Person	———	Passenger Bodily Injury Liability
C.	$ 67.20	———	$ 50,000 Each Occurrence	Property Damage Liability
D.				Single Limit Bodily Injury and Property Dam-

Optional Coverage Form (Applies to Coverages F, G, & H only)

APPLICABLE TO N-7755-T ONLY
AMOUNT OF ENCUMBRANCE $ 8,000.00

BREACH OF WARRANTY ENDORSEMENT

In consideration of an additional premium of $ 40.00 (INCLUDED & EARNED), it is hereby understood and agreed that loss, if any,

under Coverages F, G, or H of the undermentioned Policy shall be payable to SECURITY TRUST AND SAVINGS BANK

BILLINGS, MONTANA Mortgagee, as interest may appear.

Coverages F, G, and H of said policy, as to the interest therein of the mortgagee only, shall not be invalidated by any act, omission, or neglect of the Insured which shall constitute a breach of warranty or policy condition; PROVIDED, that in the event the Insured shall fail to pay any premium due under said policy, the mortgagee shall, on demand, pay the same.

PROVIDED ALSO, that the mortgagee shall notify the Company of any change of ownership or increase of hazard or breach of warranty or policy condition which shall come to the knowledge of said mortgagee and, unless permitted by said policy, it shall be noted thereon and the mortgagee shall, on demand, pay the premium for such increased hazard; otherwise, the undermentioned policy shall be null and void.

Whenever the Company shall pay the mortgagee any sum for loss or damage under the undermentioned policy and shall claim that, as to the Insured, no liability therefor existed, the Company shall, to the extent of such payment, be thereupon legally subrogated to all the rights of the mortgagee against the Insured in and to all the property held as security for the indebtedness; or the Company may, at its option, pay the said mortgagee the whole amount due or to become due from the Insured, with interest, and shall thereupon be entitled to receive a full assignment and transfer of all rights of the said mortgagee against the Insured and of all property held as security for the indebtedness.

Nothing herein contained shall vary, alter, waive or extend any of the terms, representations, conditions or agreements of the Policy other than as above stated.

To be attached to and form a part of Policy No. AC 6611

issued to AL FORHART FLYING SERVICE by

KANSAS CITY FIRE & MARINE INSURANCE COMPANY

This endorsement effective APRIL 3, 1960

C. J. CARROLL AGENCY

By J. Marshall
Authorized Representative

Morton T. Jones
President

AVI.33

Endorsement No. 1

SCHEDULE OF AIRCRAFT AND COVERAGE

Item No.	C.A.A. Certificate No.	Make and Model of Aircraft	Pass. Cap. Ex. Crew
1.	N-7755-T	1960 CESSNA 172	3
2.	N-37261	1944 INTERSTATE CADET	1
3.			
4.			
5.			
6.			
7.			
8.			
9.			
10.			

The Limits of Liability as respects Coverages A, B, C, D, and E shall be as stated in the Declarations of the undermentioned Policy and the Limits of Liability as respects Coverages F, G, and H shall be as stated below, subject to all of the terms and conditions of said Policy having reference thereto:

LIMITS OF LIABILITY — COVERAGES F, G, AND H

Item No.	Coverage F			Coverage G			Coverage H		
1.	$ 10,000.00	Less 250.00	Ded.	$ 10,000.00	Less 500.00	Ded.	$ 10,000.00	Less 500.00	Ded.
2.	$ NIL	Less $	Ded.	$ NIL	Less $	Ded.	$ NIL	Less $	Ded.
3.	$	Less $	Ded.	$	Less $	Ded.	$	Less $	Ded.
4.	$	Less $	Ded.	$	Less $	Ded.	$	Less $	Ded.
5.	$	Less $	Ded.	$	Less $	Ded.	$	Less $	Ded.
6.	$	Less $	Ded.	$	Less $	Ded.	$	Less $	Ded.
7.	$	Less $	Ded.	$	Less $	Ded.	$	Less $	Ded.
8.	$	Less $	Ded.	$	Less $	Ded.	$	Less $	Ded.
9.	$	Less $	Ded.	$	Less $	Ded.	$	Less $	Ded.
10.	$	Less $	Ded.	$	Less $	Ded.	$	Less $	Ded.

The insurance afforded is only with respect to such and so many of the following coverages as are indicated by the specific premium charge or charges as indicated below:

PREMIUM CHARGES

Item No.	Coverage A	Coverage B	Coverage C	Coverage D	Coverage E	Coverage F	Coverage G	Coverage H
1.	$ 33.12	$ 250.00	$ 33.60	$ NIL	$ NIL	$ 68.00	$ 54.00	$ 351.00
2.	$ 33.12	$ NIL	$ 33.60	$ NIL	$ NIL	$ NIL	$ NIL	$ NIL
3.	$	$	$	$	$	$	$	$
4.	$	$	$	$	$	$	$	$
5.	$	$	$	$	$	$	$	$
6.	$	$	$	$	$	$	$	$
7.	$	$	$	$	$	$	$	$
8.	$	$	$	$	$	$	$	$
9.	$	$	$	$	$	$	$	$

GENERAL ENDORSEMENT

IN CONSIDERATION OF THE PREMIUM AT WHICH THE UNDERMENTIONED POLICY IS WRITTEN IT IS HEREBY UNDERSTOOD AND AGREED THAT IN THE SPACE PROVIDED IN ITEM #7 OF THE UNDERMENTIONED POLICY DECLARATIONS THE FOLLOWING SHALL BE INSERTED:

A. WHILE THE AIRCRAFT IS BEING USED FOR PURPOSES OF STUDENT INSTRUCTION:

STUDENT PILOTS WHILE UNDER THE DIRECT SUPERVISION AND CONTROL OF A PROPERLY CERTIFICATED INSTRUCTOR PILOT.

B. WHILE THE AIRCRAFT IS BEING USED FOR PURPOSES OF BUSINESS AND PLEASURE AND TRANSPORTATION OF PASSENGERS FOR HIRE:

AL FORHART

Nothing herein contained shall vary, alter, waive or extend any of the terms, representations, conditions or agreements of the Policy other than as above stated.

To be attached to and form a part of Policy No. AC 6611

issued to AL FORHART FLYING SERVICE by

KANSAS CITY FIRE & MARINE INSURANCE COMPANY

This endorsement effective APRIL 3, 1960

G. J. CARROLL AGENCY

By [signature]
Authorized Representative

[signature: Morton T. Jones]
President

FORM KCAC-6

Endorsement No. 3

CHANGE OF AIRCRAFT OR COVERAGE ENDORSEMENT

In consideration of ......AN ADDITIONAL...... premium of ......$ 144.98......
(an additional or return)

.... Dollars, it is hereby understood and agreed that:

1. unless Limits of Liability are indicated in the appropriate column below for Coverages A, B, C, D or E, the Limit of the Company's liability shall be as stated in the Declarations of the undermentioned policy.

	LIMITS OF LIABILITY	COVERAGES		LIMITS OF LIABILITY	COVERAGES
A.	$,000 Each Person $,000 Each Occurrence	BODILY INJURY LIABILITY ....cluding Passengers	D.	$,000 Each Occurrence	SINGLE LIMIT BODILY INJURY AND PROPERTY DAMAGE LIABILITY ....cluding Passengers
B.	$,000 Each Person	PASSENGER BODILY INJURY LIABILITY			
C.	$,000 Each Occurrence	PROPERTY DAMAGE LIABILITY	E.	$,000 Each Person	MEDICAL PAYMENTS (....cluding Crew)

The Limit of Liability for the added aircraft under 2. hereof, if any, for Coverages F, G or H shall be as shown in the appropriate column below:

	LIMITS OF LIABILITY Item (a):		COVERAGES		LIMITS OF LIABILITY Item (b):		COVERAGES
F.	$5,000	Less Ded. $ 125.00	ALL RISKS WHILE NOT IN MOTION	F.	$	Less Ded. $	ALL RISKS WHILE NOT IN MOTION
G.	$5,000	Less Ded. $ 250.00	ALL RISKS WHILE TAXIING	G.	$	Less Ded. $	ALL RISKS WHILE TAXIING
H.	$5,000	Less Ded. $ 250.00	ALL RISKS WHILE IN FLIGHT	H.	$	Less Ded. $	ALL RISKS WHILE IN FLIGHT

2. the undermentioned policy is extended to cover the following aircraft:

Item	C.A.A. Certificate No.	Make and Model of Aircraft	Pass. Cap. Ex. Crew	Date Coverage Attaches
(a)	N-2306-P	PIPER PA-22	3	5-5-60
(b)				

3. the undermentioned policy CEASES to cover the aircraft designated below by the insertion of (X):
   ( ) Described in the Declarations of the undermentioned policy.
   ( ) Described as Item(s) .... of the Schedule of Aircraft and Coverage attached to the undermentioned policy.
   ( ) Described in Endorsement(s) No. .... attached to the undermentioned policy.

4. Item 6, 7 or 8 is changed to read as follows: *

SEE ENDORSEMENT NUMBER 5

GENERAL ENDORSEMENT

IN CONSIDERATION OF THE REDUCED PREMIUM AT WHICH THE UNDER-MENTIONED POLICY IS WRITTEN IT IS HEREBY UNDERSTOOD AND AGREED THAT WITH RESPECT TO AIRCRAFT N-8306-P:

1. THE LIMITS OF LIABILITY WITH RESPECT TO COVERAGE AFFORDED UNDER B OF ITEM 4 OF THE DECLARATIONS SHALL BE AMENDED TO BE:

   $ 50,000 EACH PERSON $ 50,000 EACH OCCURRENCE

   EXCEPT THAT NO COVERAGE SHALL APPLY UNDER B OF ITEM 4 OF THE DECLARATIONS WHILE THERE ARE MORE THAN TWO (2) PERSONS (INCLUDING CREW) IN THE AIRCRAFT.

2. IN THE SPACE PROVIDED IN ITEM 8(A) OF THE DECLARATIONS THE FOLLOWING SHALL BE INSERTED:

   NEW WESTERN CREDIT CORP.
   P. O. BOX 836
   BILLINGS, MONTANA

3. THE PURPOSES FOR WHICH THE AIRCRAFT WILL BE USED WILL BE "PLEASURE AND BUSINESS" AS DEFINED IN ITEM 6 OF THE DECLARATIONS AND "SPECIAL USES". THE TERM "SPECIAL USES" IS DEFINED AS "STUDENT INSTRUCTION".

Optional Coverage Form (Applies to Coverages F, G, & H only)

BREACH OF WARRANTY ENDORSEMENT

In consideration of an additional premium of $ **18.00 (EARNED)** is hereby understood and agreed that loss, if any, under Coverages F, G, or H of the undermentioned Policy shall be payable to **NEW WESTERN CREDIT CORP. P. O. BOX 836, BILLINGS, MONTANA**

Mortgagee, as interest may appear.

Coverages F, G, and H of said policy, as to the interest therein of the mortgagee only, shall not be invalidated by any act, omission, or neglect of the Insured which shall constitute a breach of warranty or policy condition; PROVIDED, that in the event the Insured shall fail to pay any premium due under said policy, the mortgagee shall, on demand, pay the same.

PROVIDED ALSO, that the mortgagee shall notify the Company of any change of ownership or increase of hazard or breach of warranty or policy condition which shall come to the knowledge of said mortgagee and, unless permitted by said policy, it shall be noted thereon and the mortgagee shall, on demand, pay the premium for such increased hazard; otherwise, the undermentioned policy shall be null and void.

Whenever the Company shall pay the mortgagee any sum for loss or damage under the undermentioned policy and shall claim that, as to the Insured, no liability therefor existed, the Company shall, to the extent of such payment, be thereupon legally subrogated to all the rights of the mortgagee against the Insured in and to all the property held as security for the indebtedness; or the Company may, at its option, pay the said mortgagee the whole amount due or to become due from the Insured, with interest, and shall thereupon be entitled to receive a full assignment and transfer of all rights of the said mortgagee against the Insured and of all property held as security for the indebtedness.

Nothing herein contained shall vary, alter, waive or extend any of the terms, representations, conditions or agreements of the Policy other than as above stated.

To be attached to and form a part of Policy No. AC 6611

issued to AL FORHART FLYING SERVICE by

This endorsement effective MAY 5, 1960 .KANSAS CITY FIRE & MARINE INSURANCE COMPANY

AGENCY

By [signature]

Authorized Representative

[signature: Morton T. Jones]

President

AVI.33

5-11-60

Endorsement No. 6

No. 18,905

United States Court of Appeals for the Ninth Circuit

KANSAS CITY FIRE AND MARINE INSURANCE COMPANY, a corporation,

Appellant,

vs.

WAYNE A. CLARK, THE MONTANA POWER COMPANY, a corporation, LEW CHEVROLET COMPANY, a corporation, and CLARENCE G. MADSEN,

Appellees.

Brief of Appellees

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Attorney for Appellee Wayne A. Clark

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Attorneys for the Appellee Clarence G. Madsen

FILED

United States Court of Appeals
for the Ninth Circuit

KANSAS CITY FIRE AND MARINE INSURANCE COMPANY, a corporation,

Appellant,

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WAYNE A. CLARK, THE MONTANA POWER COMPANY, a corporation, LEW CHEVROLET COMPANY, a corporation, and CLARENCE G. MADSEN,

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Brief of Appellees

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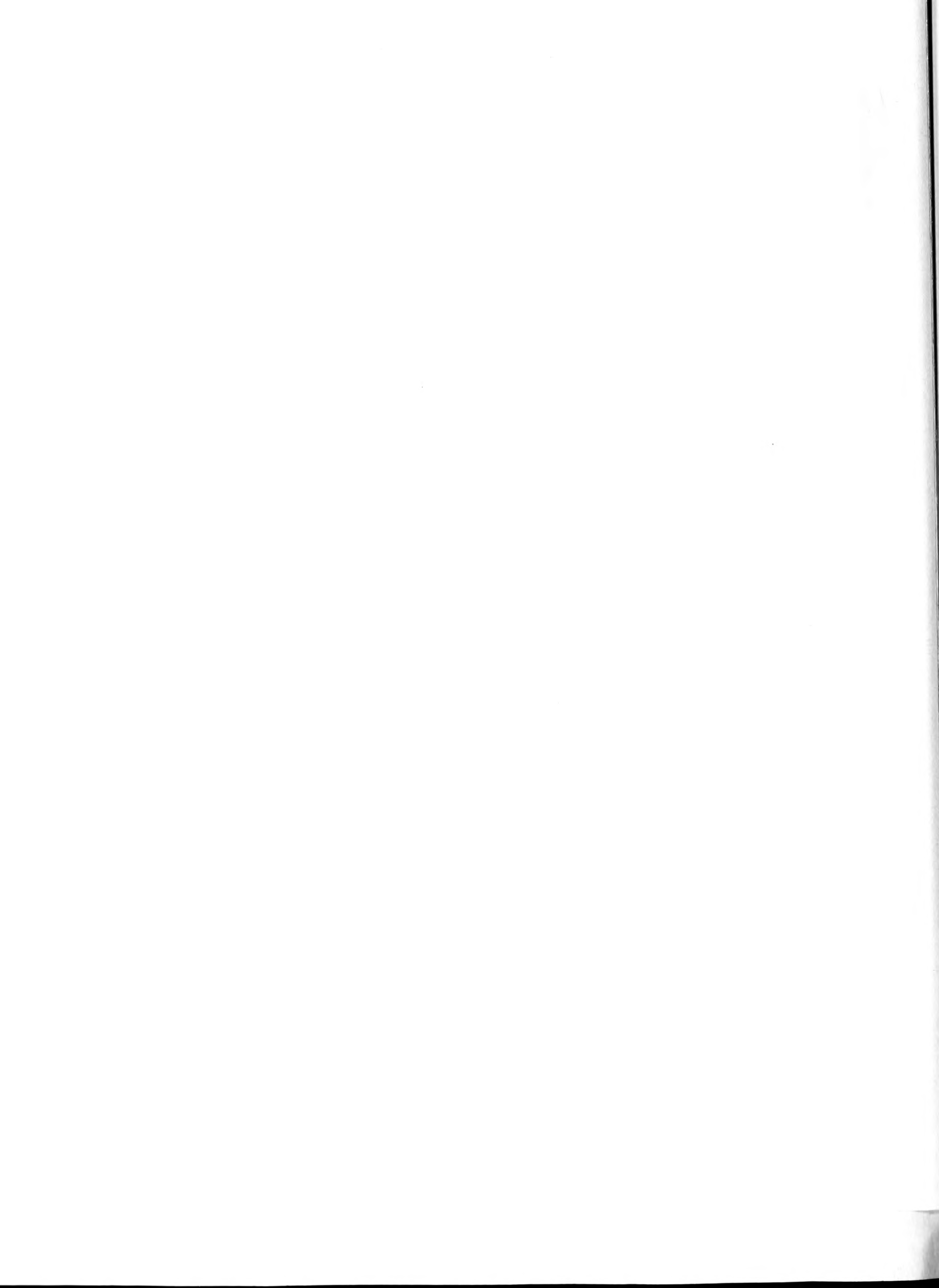

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United States Court of Appeals
for the Ninth Circuit

KANSAS CITY FIRE AND MARINE INSURANCE COMPANY, a corporation,

Appellant,

vs.

WAYNE A. CLARK, THE MONTANA POWER COMPANY, a corporation, LEW CHEVROLET COMPANY, a corporation, and CLARENCE G. MADSEN,

Appellees.

Brief of Appellees

Appellees do not agree that either the statement of the case by appellant, or its statement of the issue, are adequate. We agree with the statement concerning jurisdiction.

DESCRIPTION OF RECORD REFERENCES

The transcript of record is in two volumes which will be referred to as T1 and T2. The findings of fact are located in *T1, pages 59-68*. They are supplemented *(T1, P. 68, l. 4-7)* by the facts in the opinion by the District Court, and the opinion is in *(T1, Pp. 42-56)*. Documentary exhibits were all offered and received in evidence without objection as set forth in the pre-trial order *(T1, Pp. 21-23)*, confirmed on the date of trial *(T2, Pp. 3-5)*. Plaintiff's Exhibits 2 through 7 inclusive, described in the pre-trial order, appear verbatim in the record as Exhibits A through F *(T1, Pp. 29-39)*. When referred to hereafter, their page location in the record will be listed.

ISSUE

Appellant as plaintiff in a declaratory judgment action denied coverage to appellees under appellant's insurance policy under which appellees claim coverage for damage claims arising out of the crash of an airplane on July 26, 1960, while it was piloted by appellee Wayne Clark.

The trial judge found as fact *(T1, Pp. 59-68)*, that one Al Forhart was a properly certificated instructor pilot; that his business included student pilot instruction, part of which was the instruction of pilots who had a private license, and who were qualifying for, or upgrading to a commercial license; that appellee Clark was

the holder of a private pilot's license; that Clark was taking instruction from Forhart to upgrade his private license, which already allowed him to fly with passengers so long as it was not for hire; that as part of his instruction, the F.A.A. considered it important that he have experience in flying solo with a plane load of passengers; that prior to July 26, 1960, appellant had negotiated with and sold to Forhart a policy of liability insurance that included an "omnibus clause" which defined as an insured any person while using the aircraft, and any person or organization legally responsible for its use, providing the actual use was with permission of Forhart; that on July 26, 1960, appellee Clark was piloting Forhart's plane, carrying passengers, when it crashed at Red Lodge, Montana; that at the time Clark was taking instruction from, and was under the direct supervision and control of Forhart; that it was intended by the contract of insurance issued by appellant to Forhart that student pilots such as appellee Clark would be "insureds" as defined by the "omnibus clause"; that:

> "10. Clark was a pilot contemplated and authorized by Item 7 of the Declarations as set forth in Part A of Endorsement No. 3, and the use he was making of the aircraft was one contemplated by Item 6 of the Declarations. In other words, at the time of the crash, the aircraft was being used for purposes of 'student instruction' and was being flown by Clark as a 'student pilot under direct supervision and control of a properly certificated instructor pilot' as those terms were used in the policy of insurance. At the time of the crash, the plane was not being used

for purposes of 'business and pleasure' as that phrase is used in Part B of Endorsement No. 3 of the policy of insurance. Clark was using the aircraft with the permission of the Named Insured, within the meaning of the omnibus insured clause in the Insuring Agreements contained in the policy, and he was not operating the aircraft under the terms of any rental agreement or training program which provided any remuneration to the Named Insured for the use of said aircraft within the meaning of subparagraph (d) of the omnibus insured clause (Insuring Agreement III).

"11. From the policy, the preliminary negotiations, as shown by the exhibits, and the fact that defendant, Clark, was making use of the aircraft as a student under the direct supervision and control of Forhart in upgrading a private license, it appears that Clark while operating the plane and any person or organization legally responsible for his use, were within the terms and intent of the policy as written." *(T1, Pp. 65-66.)*

Is there ample, competent, substantial evidence in the record, worthy of belief, to support the findings of fact by the District Judge? This Court has held consistently that where the facts found are rational and reasonable, the acceptance or rejection of testimony by a trial judge is binding upon the appellate court, and will not be disturbed by the appellate court. The findings of fact by the trial judge will not be set aside unless they are so inherently improbable that they are not worthy of belief.

Distillers Distributing Corporation v. J. C. Millet Co., 9th C.C., 1962-63, 310 F. 2d 162;

Russell v. Texas Company, 1956-1957, 9th C.C. 238 F. 2d 636;

Fegles Const. Co. v. McLaughlin Const. Co., 9th C.C., 1953, 205 F. 2d 637.

In this case, the findings by the trial judge are rational and reasonable, and are supported by ample evidence worthy of belief.

SUMMARY OF EVIDENCE

a. Preliminary Negotiations with Lynch.

Al Forhart had an Airman Certificate which licensed him for Commercial flying, and as an Instructor *(Pl. Ex. 6, T1, P. 33).* In March, 1960, appellant negotiated with Forhart through its agent, Lynch, and sold to Forhart its policy of insurance *(Pl. Ex. 1).* Lynch was a licensed solicitor for appellant *(T2, P. 7).* Forhart explained to Lynch that he would be engaged in student training as well as a charter business *(T2, P. 12, l. 23-25).* Lynch knew that the student instruction phase of Forhart's business included the instruction of private pilots qualifying for a commercial ticket *(T2, P. 16, l. 1-3),* and that Forhart was qualified to give such instruction *(T2, P. 19, l. 20-26; P. 20, l. 1-3).* Forhart requested from Lynch a type of coverage that would be fitting and proper for business aviation *(T2, P. 12, l. 20-22).* Lynch outlined to Forhart the normal liability coverage carried by flight operators *(T2, P. 11, l. 22-25).* On March 28, 1960, Lynch furnished appellant's printed

application form and assisted Forhart in completing it. Forhart filled in in pen and ink his pilot qualifications. Everything inserted in the application form by typewriter was inserted by Lynch *(T2, P. 8; P. 20, l. 4-14; Pl. Ex. 6, T1, Pp. 33-35)*. Lynch filled in and applied only for the type of coverage that Forhart wanted *(T2, P. 20, l. 12-17)*.

On that same day, March 28, 1960, Lynch sent to appellant the wire requesting that it bind and quote on the coverage desired *(Pl. Ex. 2; T1, P. 29)*. The wire specified coverage for "Commercial Including Instruction Use." On March 29, appellant, by wire, refused to quote and denied writing coverage for *Commercial Operators (Pl. Ex. 3; T1, P. 30;* emphasis supplied). On March 31, Lynch wired appellant again, indicating he had air mailed the application on March 29, and that Forhart had:

> "Purchased 1960 Model 172, Cessna, for Dual purpose of *Preferred Class Student Instruction* And Limited Air Taxi Work * * *." *(Pl. Ex. 4, T1, P. 31;* emphasis supplied.)

Appellant replied on the same date, March 31, 1960, it had insufficient information to quote *(Pl. Ex. 5, T1, P. 32)*. After receiving the application, appellant on April 4, 1960, wired:

> " * * * Coverage bound 4-3-60 BI/PD And Hull Per Application Passenger 50,000 Also BI/PD Only On N37261 Uses *Charter Instruction No Rental.*" *(Pl. Ex. 7; T1, P. 36;* emphasis supplied.)

Appellant's solicitor, Lynch, testified the application had included all the coverages Forhart had asked for, and only the coverage he asked for *(T2, P. 10, l. 3-9)*; that after the quote came back, Forhart said he wanted full coverage except for rentals *(T2, P. 16, l. 18-20)*; that the only coverage applied for that was later eliminated was coverage for rentals:

> "Q. But other than the rental flying, the application included everything he wanted and everything you planned to give him, is that right?
>
> A. Yes." *(T2, P. 21, l. 1-6).*

The printed form was appellant's own form; the typewritten inserts were by appellant's solicitor, Lynch; and inserted in the application by Lynch was a specific statement that coverage was desired "while aircraft being operated by student pilots". The only restriction as to identity of pilot for coverage purposes was the restriction that Al Forhart only could pilot the aircraft while it was being used for an air taxi. By its wire, plaintiff's exhibit 7, appellant bound itself to coverage "per application". Furthermore, plaintiff's exhibits 1 through 7 were prepared by appellant, produced and offered in evidence by appellant, and received without objection.

b. The Policy.

What does the policy *(Pl. Ex. 1)* provide? Repeated reading by legally trained minds simply compounds confusion upon confusion. Item 6 of the Declarations of the policy defines the purposes for which the aircraft may be used. It contains six different uses with

a box for checking off the uses authorized. Everything is printed except the x's in the boxes which are typewritten, and except that in (f) the words "Student Instruction" were typed in.

> "Item 6. The aircraft will be used only for the purposes indicated by 'x'.
>
> X(d) 'Commercial Ex Instruction'. The term 'Commercial Ex Instruction' is defined as including all of the uses under (a) and (b) above and use of the aircraft for the transportation of passengers and or freight for hire but excluding any use of the aircraft for instruction or rental to others;".

Since the box (d) "Commercial Ex Instruction" includes the uses provided in boxes (a) and (b) of Item 6, those boxes provide:

> "(a) 'Pleasure and business.' The term 'Pleasure and Business' is defined as Personal and Pleasure use and use in direct connection with the Insured's business, excluding any operation for which a charge is made and excluding any operation of the aircraft by a student pilot;"

(This varies from the application which added: "Is coverage desired while aircraft being operated by Student Pilots? [X] Yes."; the typewritten x having been inserted by Lynch.)

> "(b) 'Industrial Aid.' The term 'Industrial Aid' is defined as including the uses enumerated in the definition of 'Pleasure and Business' and also includes transportation of executives, employees, guests and customers, excluding any operation for which a charge is made;"

A typewritten X is likewise inserted in box (f) of Item 6. It provides:

> "X(f) 'Special Uses.' The term 'Special Uses' is defined as STUDENT INSTRUCTION."

NOTE that the words "Student Instruction" signifying special uses permitted, were typewritten by appellant who prepared this document. If so intended, how easy it would have been to insert at this point: "The term 'the Insured' does not include Student Pilots, and Student Pilots are not covered by this policy." *NOTE ALSO:* There is no definition in this policy of "student", or "student pilot", or "student instruction", and no restrictions or limitations as to identity of student pilots in either application or policy.

Exclusion 2 of the Exclusions pleaded and relied upon by appellant is significant. It provides as follows:

> *"This policy* does not apply: * * *
>
> "2. to *any occurrence or to any loss or damage* occurring while the aircraft is operated, while in flight, by other than the pilot or pilots set forth under Item 7 of the Declarations." (Emphasis supplied)

If Wayne Clark as pilot, and his use of the aircraft at the time of the loss, were not within the contemplation of Item 7, no loss or damage resulting including Hull damage was covered by the policy. Item 7 of the Declarations, referred to in Exclusion 2, provides:

"Item 7.

SEE ENDORSEMENT NUMBER 3
(Typewritten)

(Printed)
only will operate the aircraft while 'in flight' and while holding proper certificate(s) as required by the Civil Aeronautics Authority."

Turning to Endorsement Number 3, it provides:

"GENERAL ENDORSEMENT (Printed)

(Typewritten)
"IN CONSIDERATION OF THE PREMIUM AT WHICH THE UNDERMENTIONED POLICY IS WRITTEN IT IS HEREBY UNDERSTOOD AND AGREED THAT IN THE SPACE PROVIDED IN ITEM NO. 7 OF THE UNDERMENTIONED POLICY DECLARATIONS THE FOLLOWING SHALL BE INSERTED:

"A. WHILE THE AIRCRAFT IS BEING USED FOR PURPOSES OF STUDENT INSTRUCTION:

STUDENT PILOTS WHILE UNDER THE DIRECT SUPERVISION AND CONTROL OF A PROPERLY CERTIFICATED INSTRUCTOR PILOT.

"B. WHILE THE AIRCRAFT IS BEING USED FOR PURPOSES OF BUSINESS AND PLEASURE AND TRANSPORTATION OF PASSENGERS FOR HIRE:

AL FORHART

(Printed)
"Nothing herein contained shall vary, alter, waive or extend any of the terms, representations, conditions or agreements of the Policy other than as above stated.

"To be attached to and form a part of Policy No. AC6611 issued to AL FORHART FLYING SERVICE

by KANSAS CITY FIRE & MARINE INSURANCE COMPANY

s/ Morton T. Jones
President

"This endorsement effective April 3, 1960.

____
Authorized Representative

Endorsement No. 3"

(In addition to the portion designated as typed, the inserts "AC 6611"; "Al Forhart Flying Service"; "April 3, 1960", were all typewritten. Once again, if it was so intended, how easy it would have been to insert at this point: "The term 'the Insured' does not include Student Pilots, and Student Pilots are not covered by this policy.")

Appellant by its conduct has interpreted the intent of the contract to mean that the foregoing Exclusion 2 does not exclude coverage in this case, and that Wayne Clark was a pilot within the contemplation of Item 7, by accepting coverage for the hull damage, by paying it, by accepting coverage for Al Forhart, and by dismissing him from this lawsuit with prejudice *(Def. Ex. 9)*. As indicated by Exclusion 2, there was no coverage whatsoever for any such loss or damage unless Clark was a pilot within the contemplation of Item 7. (Appellant

attempts to confuse this evidence of its own interpretation of the contract with waiver *(App. Br., Pp. 26-27).*)

Paragraph III of the Insuring Agreements of the policy, an omnibus clause, provides:

> "III. Definition of Insured.
>
> "The unqualified word 'insured" whenever used in this policy with respect to Coverages A, B, C, and D, includes not only the named insured but also any person while using or riding in the aircraft and any person or organization legally responsible for its use, provided the actual use is with the permission of the named insured.
>
> "The provisions of this paragraph do not apply:
>
> " * * * (d) to any person operating the aircraft under the terms of any rental agreement or training program which provides any remuneration to the named insured for the use of said aircraft."

NOTE: There is no definition in application or policy of the term "training program"; nor in any dictionary; nor in "Words & Phrases."

If it had been intended that the only person contemplated by the term "the Insured" was Al Forhart, such could have been stated in plain, simple, unmistakable, unambiguous language:

> "The only person included in the term 'the Insured' is Al Forhart."

If it had been intended that student pilots were not included in the term "the Insured", such could have been stated in plain, simple, unmistakable, unambiguous language:

> "The term 'the Insured' does not include student pilots. Student pilots are not covered by this policy.

If it had been intended that the words "training program" would include individual or any student instruction, it could have been simply stated:

> "The words 'training program' include any form of student instruction."; or

> "Students receiving any form of student instruction are to be considered engaged in a training program."

The language of application and policy, as well as conduct of appellant, indicate an entirely different intention.

Paragraph 5 of the Conditions contemplates more than one insured:

> "Severability of Interests — Coverages A, B, C, and D — The term 'the Insured' is used severally and not collectively, but the inclusion herein of more than one insured shall not operate to increase the limits of the Company's liability."

c. Testimony and Other Evidence.

Evidence from Clark and Lynch is significant. On February 15, 1961, appellant procured a written statement from Clark *(Def. Ex. 8)*, developed by appellant through request for admission of February 25, 1963; admitted in evidence without objection *(T1, P. 22; T2, P. 3)*. Answers of Clark to requests of appellant for admissions of fact were also offered and received in evidence without objection *(T1, Pp. 22, 24, 39; T2, Pp. 3-4)*. It appears that Clark had a private license which authorized him to fly and carry passengers. He had paid Forhart

$1500 for instruction leading to qualifying for a commercial license, which contemplated some hours of dual time flying with Forhart, and many hours of solo time flying without Forhart, some of which Clark had done prior to July 26, 1960, and in the aircraft involved in the accident *(T1, P. 39; Def. Ex. 8)*. Prior to July 26, 1960, Clark had flown that plane solo cross-country carrying passengers while upgrading his license *(T2, Pp. 28-29)*.

The only evidence in this record concerning the meaning of the words "training program" is in the answer of Clark to the request for admissions:

> "I was never engaged in any 'training program' with Al Forhart, and there never was any 'training program' with him, as I understand the words 'training program' to mean." *(T1, P. 39, l. 14-16)*

Appellant failed to produce any other evidence by way of explanation, contradiction, correction, or otherwise from Forhart, Lynch, or anyone else.

On July 26, 1960, Clark had received a call from Mountain Chevrolet of Red Lodge to travel to Red Lodge to look into a proposed sale *(T2, P. 27)*. At first he was going to drive to Red Lodge, and he could have driven down and back in about the same time as flying. But he was anxious to build up flight time, and decided to fly. He asked Clarence Madsen to go along. He checked out with Al Forhart who gave him the routine instructions, advised him to watch the temperature and its effect on the air density, told him about the Red Lodge airport *(Def. Ex. 8)*.

Observed by the trial judge as to manner, appearance, and the like, Clark testified:

a. "Q. Were you acquainted with the air density prior to taking off that day?

A. Yes." *(T2, P. 30, l. 9-11)*

b. "Q. Had you ever received any instruction from your instructor either verbally or in flight for taking an aircraft off with this load under the weather conditions and air density that were evident at that time?

A. When I called Mr. Forhart to get permission to use the plane there was a little discussion like it says in the statement about that."

(T2, P. 31, l. 21-25)

Clark's statement said in part:

"I checked out with Al Forhart and he gave me the routine instructions and advised me to watch the temperature and its effect on the air density and also told me about the Red Lodge airport. He gave me general information and instruction before I took off. While I was going to try to make a sale in Red Lodge at the time, my reason for flying was to build up time towards my commercial license. As far as I was concerned, I was a student under Al Forhart's instruction. On Tuesday, July 26, 1960, when I flew to Red Lodge, the business aspect of the trip was incidental. I was also a student under instruction on the flight from Red Lodge which ended in an accident. Under the instruction procedure for a commercial license, some of the training is under dual instruction, while the rest is solo, under the direction of the instructor. The flight to and from Red Lodge would be flight time under the direction of the instructor, Al Forhart. At that time I was a student pilot under instruction. Under solo flight

training mentioned above by saying that the solo flight training was under the direction of the instructor, I mean that the instructor gave instructions and direction before the take-off." *(Def. Ex. 8)*

NOTE: Appellant suggests the District Court should have disbelieved this evidence, and have found to the contrary, but cannot refer to any contrary evidence *(App. Br., P. 26)*. There is no contradiction or dispute in this record whatsoever by Al Forhart, or by appellant's soliciting agent Lynch, or by anyone else, with respect to the foregoing evidence from Clark. There is the corroborating testimony from appellant's licensed solicitor, Lynch.

Lynch, appellant's soliciting agent, described what was required to get a commercial license, which included 200 solo hours, the dual involved in the requirement for the pilot license, and some instrument training. It also required a certain amount of cross-country time in the vicinity of 40 hours *(T2, P. 18)*. He then testified:

"Q. Now a private pilot has the right to carry passengers, does he not?

A. That is right.

Q. But not for hire?

A. That is right.

Q. Now the aircraft performs differently when it has a passenger in it than when it is just flown by the pilot alone with no other occupant?

A. Yes, the performance would vary directly to the weight.

Q. And it is important in order to obtain a commercial license that the pilot experience carrying a full load of passengers, isn't it?

A. Yes, the F.A.A. recommends that under the supervision of the instructor that that ability be established.

Q. And it is generally considered in the industry that when a pilot obtains permission from his instructor to fly solo that he is under the supervision of the instructor when he gets permission to take the aircraft alone, isn't that right?

A. That is right." *(T2, P. 18, l. 12-26; P. 19, l. 1-6)*

Note: Appellant quotes only part of this testimony of Lynch and objects because the District Court considered and believed all of it along with Clark's corroborating evidence *(App. Br., Pp. 24-25)*.

Lynch also testified that the cross-country flying involved traveling cross-country from one airport to another regardless of how short the trip might be *(T2, P. 21, l. 10-17)*. There is no contradiction nor dispute in this record whatsoever of the foregoing evidence from appellant's agent Lynch.

While Clark was on the stand as a witness, appellant produced and had him examine the F.A.A. report of the accident *(T2, P. 29)*. Appellant did not put the report in evidence. It is not unfair to suggest and infer that there were no flight violations that would affect coverage, or appellant would have so contended and so proved.

d. Summary.

Considered in the light of Montana law, the foregoing evidence in the record, worthy of belief, is ample, competent, substantial support for the findings of fact by the District Judge. Under such evidence, the findings and conclusions are rational and reasonable.

The trial court found as fact that under a reasonable construction of the contract as written, Clark and his employer were and are omnibus insureds. When we consider in addition the interpretation of the contract by appellant through its conduct, the intention of the parties gleaned from the negotiations, application, and telegrams, and the morass of ambiguous fine print clauses which not only conflict between themselves, but which contradict and conflict with the typewritten inserts, all of which were inserted by appellant and which do not negative such intent, the evidence is overwhelming.

If the Court deems it necessary, in order to give expression to that intent, for the Court to reform the contract to more clearly express the intent, or to estop appellant from denying that intent, the Court can resort to the additional evidence.

> *Peerless Casualty Co. v. Mountain States Mutual Casualty Co., Mont. 9th C.C., 283 F. 2d 268.*

ARGUMENT

A. *MONTANA LAW.*

In Montana, contracts of insurance should be given a fair and reasonable construction such as intelligent businessmen would give them, rather than a strict or

technical construction such as a skilled insurance lawyer or executive might give. A cardinal principle requires that the contract of insurance be construed liberally in favor of the insured and against the insurer. Whenever a contract is so drawn as to be uncertain, or ambiguous and to require construction, and the contract is fairly susceptible of two constructions, the one favorable to the insured will be adopted. The policy holder must be protected against conflicting, confusing and ambiguous statements in policies. If it is intended to exclude persons or uses from coverage, such must be done expressly in plain, simple, and unambiguous language.

In Montana, the whole of a contract must be taken together, so as to give effect to every part if reasonably practical, each clause helping to interpret the other, and a party cannot single out isolated words, or phrases, or paragraphs, without regard to the remaining language of the contract. Furthermore, the written parts of a contract control the printed parts. When the parties to a contract of doubtful, or ambiguous meaning have placed a particular interpretation upon it, that interpretation is one of the best indications of their true intent.

On the other hand, courts must give effect to express language which clearly and plainly reflects the intention of the parties. Courts cannot change a contract clearly expressed.

1. In Montana, effect must be given to every part

of the contract so that the whole is taken together, and each clause is used to interpret the other.

13-707, R.C.M. 1947.

2. Written parts of a contract control over the printed parts.

13-717, R.C.M. 1947.

3. In *Musselshell Valley F. & L. Company v. Cooley, 86 Mont. 276, 283 Pac. 213,* our court said:

> "Every intention of the parties to a deed is to be ascertained, if possible, from its language, not as it is presented in particular sentences or paragraphs, but according to its effect when viewed as an entirety. (Citing cases.) Moreover, where parties to a contract of doubtful or ambiguous meaning have placed a particular interpretation upon it, that interpretation is one of the best indications of their true intent." *(86 Mont. at 294)*

4. Technical words are to be interpreted as usually understood by persons in the profession or business to which they relate, unless clearly used in a different sense, and the meaning must be proved.

13-711, R.C.M. 1947.

After recognizing that when the terms of a contract are clear and unambiguous the contract is not subject to interpretation and the language of the contract governs, the Montana court in *Lehrkind v. McDonnell, 51 Mont. 343, 153 Pac. 1012,* stated in part with respect to a contract which is ambiguous:

> " * * * but when it contains terms or expressions which are of doubtful import, the necessity for in-

terpretation arises. It is then incumbent upon the court to ascertain, by resort to proof of the attendant circumstances, as to what the mutual intention of the parties was at the time it was made. * * * Technical words are to be interpreted as usually understood by persons in the profession or business to which they relate, unless clearly used in a different sense (Rev. Codes, sec. 5034); but a court cannot usually ascertain from the writing alone whether such an expression has a technical meaning, and, if so, what that meaning is, for it cannot take judicial notice of such matters. Nor may it take judicial notice that the parties intended to use it in that sense. Here a clear issue was presented as to the mutual intention of the parties in the use of the expression in question, and it was competent for the court to admit, as it did, evidence showing the circumstances under which the parties conducted and concluded their negotiations — not to contradict, enlarge or vary the terms of the written instrument, but to enable the jury to ascertain the mutual intention of the parties, and hence whether the plaintiff or the defendant was guilty of a breach of the contract."

(51 Mont. at 353)

5. Montana's Uniform Aeronautics Code defines some terms, but does not define "student", "student pilot", "student instruction", or "training program".

1-102, R.C.M. 1947.

Neither "Words & Phrases" nor any dictionary defines "training program". The opinion of the district court so notes. *(T1, Pp. 51-52)*

6. In the case of *Park Saddle Horse Company v. Royal Indemnity Company, 81 Mont. 99, 261 Pac. 880, 1927,* the original policy involved covered the trade or

business of the insured as an operator of saddle and pack horses in Glacier Park, Montana, and vicinity, and provided:

> "It is understood and agreed that the undermentioned policy is intended to apply and shall apply exclusively to liability as in the policy defined and limited, arising by reason of the maintenance and/or use of saddle and pack horses."

The trial court construed the policy by substituting in place of the words "by reason of the maintenance and/or use of saddle and pack horses" the words "out of assured's saddle and pack horse business". A party of four tourists engaged the plaintiff to conduct them as a saddle horse party on a two-days' trip over established mountain trails in the park. They were placed in the charge of a regular guide. The guide became lost. It was necessary for the tourists to dismount from their horses from time to time, and occasionally the guide directed them to dismount; and at one place, while dismounted at the direction of the guide, one of the ladies of the party in going over a steep mountainside on foot, where there was no path or trail and while she was using due care, slipped, caught her heel and fell, wrenching and twisting her knee and injuring her leg. The named insured was required to pay $1,000 for those injuries. He thereupon sued the liability insurer. The general principles which are still followed by our present Supreme Court with reference to the construction of insurance contracts are stated in the decision as follows:

> "Contracts of insurance should be given a fair and reasonable construction such as intelligent business men would give them, rather than a strict or technical construction. It should be borne in mind that it is a cardinal principle of insurance law that a contract of insurance is to be construed liberally in favor of the insured and strictly as against the insurer. (32 C.J. 1152.) Whenever a contract of insurance is so drawn as to be ambiguous or uncertain, and to require construction, and the contract is fairly susceptible of two constructions, one favorable to the insured and the other favorable to the insurer, the one favorable to the insured will be adopted. (Citing cases.) It is also an established principle that in construing policies of this general character the words of the agreement are to be applied to the subject matter about which the parties are contracting at the time, the presumption being that the matter is in the minds of the parties when contracting. (Citing case.)" *(81 Mont. at 111)*

7. The most recent statement of the Montana rule which fully accords with the statement of the Ninth Circuit Court on rehearing in the *Eagle Star* case cited later on is found in *Holmstrom v. Mutual Benefit Health & Accident Association, September 18, 1961, Vol. 18, St. Rep. 355, 139 Mont. 426, 364 P. 2d 1065,* in which our Court said:

> "In our judgment this sentence is not consistent with the more boldly printed portions of the policy previously noted. It is not only ambiguous but conflicting. Here the appellant insured a man of 43, and continued to take his premiums for said insurance for a period of 31 years during which time he had no reason to believe that he did not have a non-cancellable policy. The time has passed when re-

sponsible insurance companies can hide, in the fine print, escape clauses that will leave responsible citizens uninsured in their senior years.

"*The policy holder must be protected against conflicting, confusing and ambiguous statements in policies* and whenever there are two constructions that can be placed upon a policy this court believes the better rule is to apply that construction most favorable to the policy holder." (Emphasis supplied)

8. In *Auto F. Corp. v. British, etc., Underwriters, 72 Mont. 69, 232 Pac. 198:*

"In view of the foregoing, we deem the interpretation of the words 'federal', 'state', and 'municipal', contended for by the defendants, too restrictive.

"If there is any uncertainty as to whether these terms are employed in their restricted signification so as to have reference solely to the United States or are used in an enlarged sense so as to include Canada, then that construction should be adopted which is beneficial to the insured (citing case), or, to state the rule applicable in language approved by this court:

" 'No rule in the interpretation of a policy is more fully established, or more imperative and controlling, than that which declares that in all cases it must be liberally construed in favor of the insured, so as not to defeat without a plain necessity his claim to the indemnity, which in making the insurance was his object to insure.' (May on Insurance, sec. 175.) (Citing case.)" *(72 Mont. at 74)* (Followed by the language quoted in the opinion of the District Court at *T1, P. 47.)*

9. In *Johnson v. Continental Casualty Co., 1953, 127 Mont. 281, 263 P. 2d 551,* the Court said:

"Section C(a) of the insurance policy reads: 'Injuries coming within provisions of Section C of this part, are those sustained in consequence of: (a) The wrecking of any private pleasure type automobile or animal drawn vehicle within which the assured is driving or riding as a passenger, or the wrecking of any private commercial automobile, motor-driven car, truck, wagon or animal-drawn vehicle (excluding motorcycles and farm machinery) within which the insured is driving or riding and while being used for transporting merchandise for a business purpose (provided the insured is not operating any such vehicle while carrying passengers for hire), or being accidentally thrown from such automobile, car or vehicle while so riding or driving.'

"The determinative question on the appeal is whether a caterpillar tractor is a motor-driven car or truck within the meaning of the policy of insurance. The district court answered in the affirmative and we think correctly.

"In interpreting the policy of insurance the district court, as well as this court, shall resolve uncertainties and ambiguities in the policy against the insurer since it is responsible for the form of the contract. (Citing Montana authority.) When the contract is so interpreted we are led to the conclusion reached by the trial court.

"The contract used the terms 'private commercial automobile', and 'truck' and it is evident that by the use of the all-inclusive term 'motor-driven car' the parties intended something more than what is usually denominated an automobile or a truck. This is further evidenced by the clause '(excluding motorcycles and farm machinery)'. The only reasonable excuse for this exclusion clause is that without it the parties intended that motorcycles and all forms of motor-driven farm machinery would be included

within the comprehensive classification of 'motor-driven cars (or) trucks.' *Had defendant desired to exclude any other motor-driven vehicle than motorcycles and farm machinery it should have done so expressly.*" (Emphasis supplied; *127 Mont. at 282.)*

10. In *Keating v. Universal Underwriters, 1958, 133 Mont. 89, 320 P. 2d 351,* defendant insurer issued to plaintiff insured a garage liability policy whereby defendant agreed by Coverage D:

" 'To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of injury to or destruction of property of others of a kind customarily left in charge by garages, including the loss of use thereof, caused by accidental collision or upset of such property while in charge of the named insured in connection with his automobile dealer, repair shop, service station, storage garage or public working place operations.' But defendant provided for a number of exclusions from this coverage, two of such exclusions being:

" '(a) to liability assumed by the insured under any contract or agreement except a warranty of goods or products;'

" '(h) under coverage D, to injury or destruction caused directly by fire or theft; or to injury or destruction of (1) property owned or loaned or rented to the named insured, or (2) automobiles being driven or transported from the factory or other wholesale distributing point to the purchaser or for storage.' " *(133 Mont. at 91)*

Plaintiff insured had an automobile in the garage under a trust receipt to General Motors which he stored, demonstrated, and attempted to sell during the course of

which it was wrecked. General Motors demanded payment, defendant denied coverage. The Court said:

> "Thus, the ultimate questions are whether the insured is responsible to General Motors Acceptance Corporation, independently of contractual liability, for loss of the car within the meaning of the insuring clause, 'To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of injury to or destruction of property of others of a kind customarily left in charge of garages * * * caused by accidental collission or upset of such property while in charge of the named insured in connection with his automobile dealer * * * operations;' and whether the automobile was 'property owned' by plaintiff within the meaning of the exclusion clause of the insurance policy."
>
> *(133 Mont. at 93)*

The Court discussed the arguments of counsel concerning the relationship between General Motors and plaintiff insured, and then said:

> "Whichever may be the correct position, it appears that all of the cases cited as supporting one or the other involve creditors of or buyers from the trustee and some miscellaneous situations, and none of the cases cited, or which we have been able to discover, involve the first problem here posed, that is, whether or not the car was the 'property of others' or 'owned (by) the named insured' within the meaning of those phrases as employed in the insurance policy.
>
> "It has been held that the term 'owner', when used alone, imports an absolute owner or one who has complete dominion over the property owned as the owner in fee of real property, (citing case), and that the words 'owned by' mean an absolute and unqualified title, (citing case). Whether such is the

meaning of the phrases here in question, or if the meaning is varied according to the connection in which they are used, and they are to be understood according to the subject matter to which they relate, (citing case), it is certain, from the defendant's viewpoint alone, the phrases are at best generic and general and not specific and hence ambiguous and uncertain. *The phrases are not defined in the insurance policy, nor is there any phraseology or conditions therein, nor is there anything in the facts submitted to this court from which may be inferred any qualified meaning,* (Emphasis supplied) and, standing alone, we cannot say that these phrases were intended to exclude from the insurance coverage property possessed for sale only and to which the legal title resides in another, even though it be for security purposes alone.

" * * * *If the defendant insurer had intended to exclude 'floored' automobiles from coverage, it would have been a simple matter for the insurer to have clearly and unequivocally provided therefor by the simple expedient of specifically referring to trust receipts and floor plans in the exclusion clause thereby removing all doubt.* (Emphasis supplied) The law is plain that the ambiguity and uncertainty caused by the phrases in question must be resolved in favor of the plaintiff insured and against the defendant insurer. (Citing and quoting Johnson v. Continental Casualty Co., and Montana Auto Finance Corp. v. British Etc. Underwriters.)"

(133 Mont. at 95-96)

In this case, appellant was required by Montana law to define in plain, simple, unambiguous language the words "student", "student pilot", "student instruction", or "training program", if appellant desired some specific application of those terms. If not defined clearly in the

policy, appellant had the burden of proving by a preponderance of the evidence the intent and meaning appellant urges, which was not done in this case. The only evidence available to the trial court was the evidence from Clark.

If the appellant intended that Al Forhart, and Al Forhart alone, was an insured under its policy, it was required by Montana law to expressly so state in plain, simple, unambiguous language. If the words "training program" included solo flight instruction to a single, private pilot, appellant was required to so state in plain, simple, unambiguous language. How extremely simple and easy it would have been to state in its contract:

a. "Al Forhart, and Al Forhart alone, is the only person insured under this contract;" or

b. "The term 'the insured' does not include student pilots. Student pilots are not covered by this policy."; or

c. "The words 'the training program' mean any form of student instruction."; or "Students engaged in any form of student instruction are engaged in a training program."

Having failed to do so, and having failed to prove otherwise by competent evidence, appellant is bound by the reasonable construction adopted by the District Court.

In this connection, neither the general dictionary, nor the law dictionary, nor Words & Phrases, defines "training program". The policy and the application do not define what is contemplated by the words "training program". The only evidence concerning the mean-

ing and intent of the words "training program" is from Clark. He stated that he was never engaged in any "training program" with Al Forhart, and there never was any "training program" as Clark understood the words "training program" to mean *(T1, P. 39)*. Although appellant had the burden of proof, there is no other testimony, and no other evidence, to contradict, dispute, or explain this statement by Clark. Did it contemplate federal and state training programs such as the Civilian Pilot Training Program under the Civil Air Patrol Act *(Title 36 USCA, Section 202, etc.);* or under the civilian schools and programs auxiliary to the promulgation of the expansion of aviation in general, *Title 10, USCA, §§ 9305, 9384, 9411-9413, 9441*; or the training programs financed under the G. I. Bill under contracts with the Veteran's Administration such as were considered in the *Petro* case discussed in the opinion of the District Judge; or state university flying schools such as were involved in *LeBlanc v. American Employers, La.,* cited hereafter; or civilian cadet schools? The words "training program" certainly do not contemplate nor connote the personalized, individual dual and solo instruction and certification of Wayne Clark by Al Forhart.

Furthermore, if "student instruction" and "training program" are synonymous terms, as urged by appellant, why did appellant insert in the application by typewriter that coverage was desired "while aircraft being

operated by student pilots"; in box (f) of Item 6 of the Declarations that the term "Special Uses" is defined as "STUDENT INSTRUCTION"; in Item 7 of the Declarations that the aircraft would be used for purposes of student instruction, by student pilots under supervision and control of an instructor pilot, with no limitation as to identity of pilots. Why an omnibus clause? Why a severability of interests clause? Why an exclusion for use by pilots not contemplated by Item 7? Why pay the hull loss so excluded if Clark was not a pilot contemplated by Item 7? Why insert by typewriter a restriction that only Forhart was insured while transporting passengers for hire if it was intended that Forhart was the only insured for any and all flying uses or purposes? Appellant does not explain the ambiguities and conflicts between the fine print clauses, not to mention the conflict between fine print clauses and typewritten inserts, all promulgated by appellant or its soliciting agent.

B. *APPELLANT'S AUTHORITIES.*

Without citation of authority, appellant states that the rules of construction laid down by the Montana Court are not applicable to third parties (*App. Br., P. 19*). Omnibus insureds are not in a class of third party strangers; and are in fact "insureds" entitled to a proper construction:

> "An omnibus clause creates liability insurance not only for the benefit of the named insured, but also

> for the benefit of those who come under the clause and meet its requirements; or, in other words, it does not afford additional protection to the owner, but extends protection to third persons operating the vehicle with the insured's consent. An additional insured need not have an independent insurable interest to come within the protection of the omnibus clause. Of course, the necessary relationship between the additional insured and the owner must appear in order to bring such person within the protection of the contract. And, an endorsement added to a policy containing such a clause modifies the terms of the original policy to that extent. The construction of liability or nonliability is not determined solely by the law of principal and agent.
>
> "Protection then vests in the additional insured to the same extent as if he were the named insured and had been driving. The coverage itself is not enlarged, merely the persons insured being thereby increased in number * * *."
>
> *(Vol. 7, Appleman, P. 243, §4354)*

The "Severability of Interests" clause in the Conditions *(Par. 5)* provides that the term "the Insured" is used severally and not collectively.

The cases cited by appellant, all from other jurisdictions, are actually consistent with the foregoing Montana decisions. We have no quarrel with the results in those cases cited by appellant under the facts they considered. For example, in *Farm Bureau Ins. Co. v. Daniel, 4th C.C., 104 F. 2d 477,* cited by appellant, use of the truck for purposes of a garage business was not provided in the declarations. The Court refused to use the omnibus clause, defining persons insured, to extend or

broaden the uses defined in the declarations. We have no quarrel with that view. In our case, the Declarations typed in by appellant spelled out that special uses of the craft would include student instruction, and by student pilots. Appellant would have this Court take an isolated, printed term from the omnibus clause — training program (which is not defined in application, policy, or dictionary and concerning which appellant submitted no evidence despite appellant's burden of proof), reject the fact determination by the trial court which is based upon the only evidence in the record, the evidence from Clark, and destroy or eliminate the uses expressly authorized by appellant in the declarations inserted by appellant by typewriter. Appellant asks this Court to do essentially what the 4th Circuit refused to do in the *Farm Bureau* case, use the omnibus clause to modify the uses provided for in the declarations, and goes still further in asking this Court to substitute appellant's discretion based on no evidence, for the trial court's discretion based on the only evidence.

Standard Surety & Casualty Co. v. Maryland Cas. Co., N.Y., 119 N.Y.S. 2d 795, is cited by appellant. We do not quarrel with this decision. Coverage A in the declarations provided the insurer agreed to pay on behalf of the insured damages for injuries sustained by any person. The Exclusions categorically provided:

> "This policy does not apply: * * *
>
> (d) Under Coverage A to bodily injury to * * * any employee of the insured * * *."

The injured claimant was an employee of the insured on business of the insured while hurt. The Court properly held there was no coverage.

Lambert v. New England Fire Ins. Co., Maine, 90 A. 2d 451, likewise simply gives effect to a clearly expressed exclusion clause.

Massachusetts Mutual Life Ins. Co. v. Pistolesi, Cal., 9th C.C., 160 F. 2d 668, accords with Montana law. "Training program" is not defined in any dictionary, nor in "Words & Phrases". Under Montana law appellant had the burden of proving its meaning.

We cannot see why appellant cites *Insurance Co. of North America v. General Aviation Sup. Co., 8th C.C., 283 F. 2d 590.* The lower court because of ambiguities and conflicts in the policy held coverage as did the lower court in this case. In affirming, the Eighth Circuit Court said in part:

> "The insurance company relies on the evidence that the plaintiff, in carrying on its business of selling supplies to persons and to organizations that sell, service, and repair or use aircraft constantly refers in its extensive catalogue, merchandise descriptions, and sales talks to what it calls the 'aviation industry,' and 'aviation trade' and 'aviation business.' The contention is in substance that the word aviation ought to be given the same meaning in the question policy phrase as it has when so combined with the words 'industry,' or 'trade,' or 'business,' as if the phrase read to exclude 'sales organizations in the aviation industry,' 'service organization in that industry, etc.'

> "But there was no evidence that the policy phrase 'aviation sales organization,' etc., was ever used to define the plaintiff's business. It appears to have been coined by the insurer's scrivener and there is no definition of the phrase in the policy. Having affirmatively expressed the coverage in a broad promise to defend and to indemnify, it was incumbent on the company to define the exclusions from that promise in clear terms. There is at least ambiguity here, whether the policy's intention is to exclude organizations like the named insured which sell, service and repair aircraft, or whether it is more broadly meant to exclude also organizations like the plaintiff which do none of those things, but do sell supplies and equipment." *(P. 592)*

The burden is upon appellant to demonstrate error. To obtain a reversal appellant must show the conclusion reached by the trial court is irrational, illogical, unsound or contrary to any local or general law applicable to the interpretation of an insurance contract *(258 F. 2d at 592-593)*. Appellant cannot point to any evidence or to any local law so indicating. The evidence and the local law suggest otherwise. We can adopt the concluding sentence from the 8th C.C. opinion:

> "We conclude that the decision of the trial court on the point in issue here was a permissible one under local law." *(258 F.2d at 593)*

None of the cases cited by appellant differ from the views of the Montana Supreme Court, nor do they support in any way an argument that the District Judge in this case was in error in his findings of fact, conclusions of law, or opinion.

C. *CASES FROM OTHER JURISDICTIONS.*

1. *United States v. Eagle Star Ins. Co., 9th C.C., Wash., 196 F. 2d 317, reversed 201 F. 2d 764;*
2. *Prudential Insurance Company of America v. Barnes, Ariz., 9th C.C., Dec. 21, 1960, 285 F. 2d 299;*
3. *Petro v. Ohio Cas. Ins. Co., D.C., Calif., 95 F. Supp. 59;*
4. *Fireman's Fund Insurance Company v. McDaniel, 187 F. Supp. 614,* opinion affirmed and adopted, *5th C.C., 289 F. 2d 926;*
5. *Ins. Co. of No. Amer. v. General Aviation, 8th C.C., 283 F. 2d 590;*
6. *Hall's Aero Spraying v. Underwriters of Lloyd's London, 1960, 5th C.C., 274 F. 2d 527;*
7. *Great American Indemnity Co. v. Sultman, 8th C.C., 213 F. 2d 743, cert. den. 348 U.S. 862;*
8. *Thompson v. Ezzell, Wash., 1963, 379 P. 2d 983;*
9. *Steven v. Fidelity and Casualty Co. of New York, Sup. Ct. in Banc, Calif., 1963, 377 P. 2d 284;*
10. *Butche v. The Ohio Casualty Ins. Co., 1962, Sup. Ct., Ohio, 187 N.E. 2d 20;*
11. *Continental Cas. Co. v. Warren, Texas, Sup. Ct., 1953, 254 S.W. 2d 762;*
12. *48 A.L.R. 2d 704,* and *9 A.L.R. 2d 581.*

D. *ESTOPPEL.*

It should not be necessary in this case to utilize the doctrines of reformation or estoppel to give effect to the intent of the parties, or to bar appellant from denying

the intent. There is ample uncontradicted evidence to utilize the reformation or estoppel under the Montana cases.

With respect to estoppel, there are the following cases:

Curtis v. Zurich, 108 Mont. 275, 89 P. 2d 1038;

Stevens v. Equity Mutual Fire Insurance Company, 66 Mont. 461, 213 Pac. 1110;

Baker v. Union Assurance Society of London, Limited, 81 Mont. 281, 264 Pac. 132;

Thielbar Realties, Inc. v. National Union Fire Insurance Company, 91 Mont. 525, 9 P. 2d 469;

McGaffick v. Ligland, 130 Mont. 332 at 353, 303 P. 2d 247;

Lindblom v. Employers Liability Assurance Corporation, 88 Mont. 488, 295 Pac. 1007.

CONCLUSION

Appellant had the burden of proving its claims to the trial court by a preponderance of the evidence. The findings and conclusions of the trial court are based upon the only evidence in the record, all of which is uncontradicted, undisputed, unexplained. Appellant urges the trial court was in error because it did not arrive at different findings and conclusions, but fails to point to any evidence to warrant different findings and conclusions. It fails to do so because there is no other evidence in the record, because appellant wholly failed to produce any evidence to the contrary. The findings and conclusions of the trial court are the only logical

results when the evidence is weighed and considered in light of Montana statutes and case decisions.

A convincing and compelling construction of the policy as written affords coverage to Wayne Clark and his employer, Lew Chevrolet Co., as omnibus insureds. If there is any doubt arising out of one of the most ambiguous and uncertain contracts these appellees have ever examined, that doubt is wholly and completely resolved when we refer to the additional evidence offered by appellant, and admitted without objection — the undisputed oral negotiations, and the undisputed documentary exhibits. The evidence of an intent to extend coverage to the omnibus insureds is overwhelming.

The findings of fact and conclusions by the trial Judge are rational and reasonable, and are supported by ample, competent, substantial evidence worthy of belief. Neither reformation of the contract, nor estoppel to deny the intent of the contract, should be required. If deemed necessary, however, there is ample uncontradicted evidence to compel either one or the other under Montana law.

Respectfully submitted,

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By CALE CROWLEY
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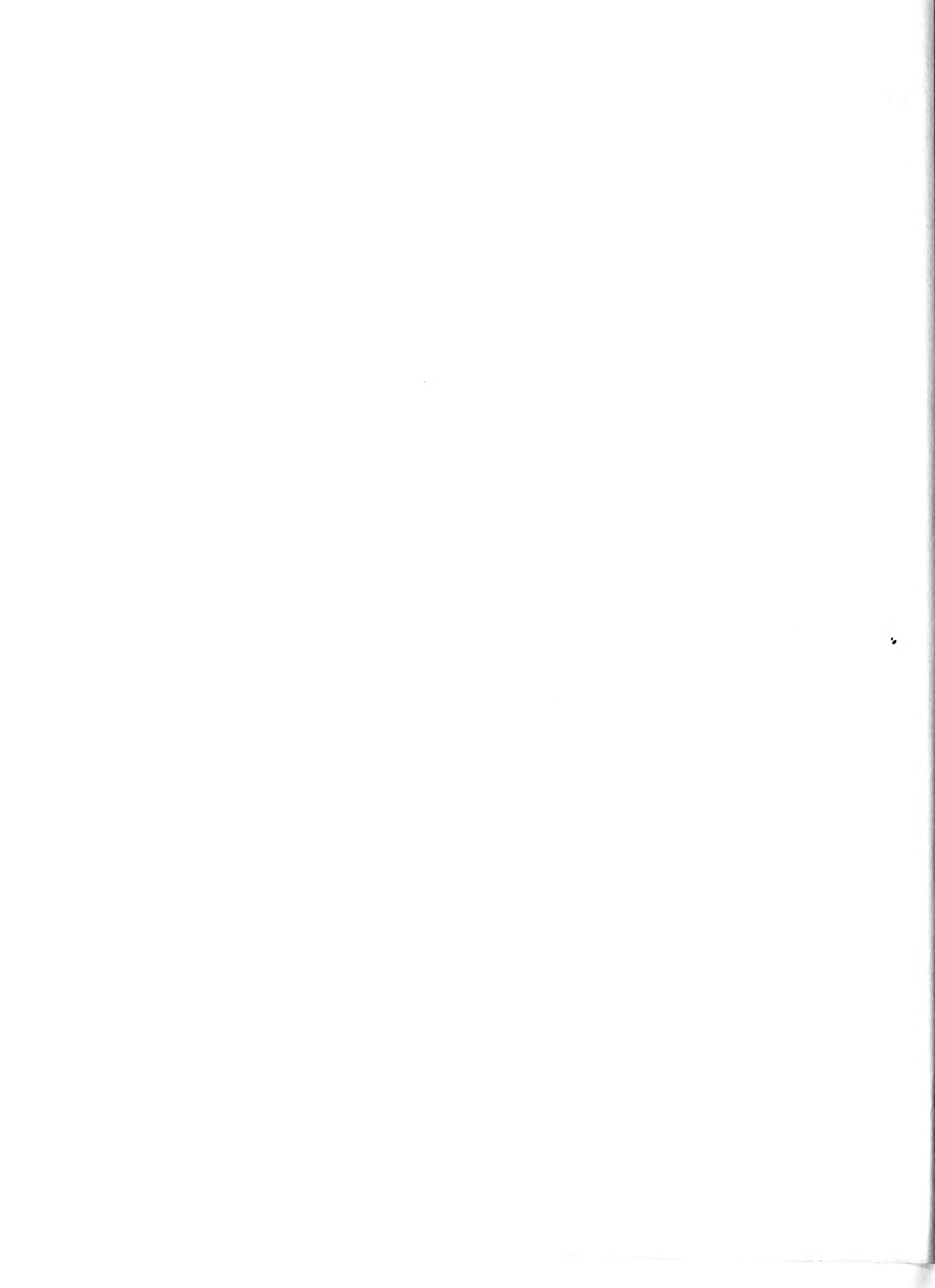
I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance wtih those rules.

CALE CROWLEY
One of the Attorneys for Appellees.



No. 18,905

United States Court of Appeals

For the Ninth Circuit

KANSAS CITY FIRE AND MARINE INSURANCE COMPANY, a corporation,
Appellant,

vs.

WAYNE A. CLARK, THE MONTANA POWER COMPANY, a corporation, LEW CHEVROLET COMPANY, a corporation, and CLARENCE G. MADSEN,
Appellees.

APPELLANT'S REPLY BRIEF

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APPELLANT'S REPLY BRIEF

---

1. There is no such rule—as stated by appellees—that "findings of fact by the trial judge will not be set aside unless they are so inherently improbable that they are not worthy of belief."

The question presented here is whether there is any evidence to support two findings: (1) that Clark was not operating the aircraft under any training program (Tr. vol. One, 66:14-16) and (2) that at the time of the crash Clark was under the direct supervision and control of Forhart (id. 61:20).

Appellees' brief asserts:

> The findings of fact by the trial judge will not be set aside unless they are so inherently improbable that they are not worthy of belief. (p. 4.)

There is no such rule. Appellees cite *Distillers Distributing Corp. v. J. C. Millett Co.*, 310 F. 2d 162. There the correct rule is stated, viz: that a finding supported by evidence will not be disturbed unless the *evidence* is "so inherently improbable as not to be worthy of belief". In the case at bar the evidence—the policy of insurance and the circumstances of the crash—was not sufficient to support the findings. On the contrary, the evidence required findings (1) that Clark and Chevrolet Co. were not insured; and (2) that at the time of the crash Clark was not under the direct supervision and control of Forhart.

2. The preliminary correspondence and application do not constitute the contract. The policy controls the rights and obligations of the parties.

Pages 5-7 of appellees' brief discuss the "preliminary negotiations". These consisted of the exchange of telegrams and an application for the insurance. They do not constitute the contract. The final and sole repository of the rights and obligations of the parties is contained in the policy of insurance.

Furthermore, the correspondence contains no indication as to who besides Forhart was to be insured; hence, the correspondence could not have any legal effect on the point in controversy.

Appellees (br. p. 7) also refer to the telegram from Cravens, Dargan & Company (Ex. 7) which constituted a temporary binder. Appellees assert:

> By its wire, plaintiff's exhibit 7, appellant bound itself to coverage "per application".

Appellees do not indicate whether or not they place any reliance on this telegram or if so, what effect it has on the issues. In any case the answer is that a binder is in force pending the issuance of a policy. At that point the binder is superseded. This is axiomatic.

Consequently, the legal status of Lynch, who corresponded with Cravens, Dargan & Company, is immaterial. Appellees repeatedly refer to Lynch as appellant's agent (br. pp. 5, 17); appellant's solicitor (pp. 5, 7, 17); and soliciting agent (p. 16). Although the subject requires no comment, it is noteworthy that the telegrams were signed by Lynch Flying Service Inc. and the replies were addressed not to Lynch but to C. J. Carroll Agency. Lynch was the operations manager of Lynch Flying Service Inc. (Tr. vol. Two, 6:2.) He was also a licensed solicitor under the C. J. Carroll Agency (id. 7:3-5) pursuant to section 40-3321 of the Insurance Laws of Montana, section (4) of which provides:

> A solicitor shall not have authority to bind risks or countersign policies.

Lynch was not an employee of appellant, nor of Cravens, Dargan & Company. If appellees seek to convey the impression that Lynch had authority to bind the insurance company, the foregoing discussion should suffice to dissipate it.

3. Appellees ignore the proposition that the policy contains separate and independent provisions as to the identity of the insured and the permitted use of the aircraft.

The policy contains a clause determining the identity of those—besides Forhart—who come within the category of "insured". If Clark is not included, that is the end of the case.

But even assuming that Clark was an insured there arises another question, viz., whether the flight was under the direct supervision and control of Forhart.

Appellees' brief does not dispute these aspects of the appeal. But in their argument they indulge in a hopeless jumble of these two separate and independent clauses. This would be understandable if the distinction had not

been labored in the insurance company's opening brief. It is the sole subject of section 1. (pages 8-11.)

Appellees fail to offer any answer to this point. There is none. The rule that various clauses in a contract may be used to aid in the interpretation of each other is applicable only where the clauses pertain to the same subject. In the case at bar the two clauses are completely different in their purpose and application.

Exemplifying appellees' confusion of the two provisions are the following:

(a) In Item 6 of the Declarations one of the subdivisions (f) is headed SPECIAL USES. There follows: "The term SPECIAL USES is defined as student instruction." Appellees argue that at this point the policy should have proceeded to say: "The term 'the insured' does not include Student Pilots, and Student Pilots are not covered by this policy". (br. 11.)

The obvious answer is that the subject of special uses is altogether different from that of the identity of those insured by the policy. This was not the proper place for a provision with respect to a different subject.

(b) Item 7 of the Declarations contains the words "See Endorsement No. 3". This endorsement contains the provision concerning permitted use for student instruction. Appellees (br. p. 11) make the same argument as above, saying:

> Once again, if it was so intended, how easy it would have been to insert at this point: "The term 'the Insured' does not include Student Pilots, and Student Pilots are not covered by this policy".

The same answer as stated above is appropriate. Endorsement No. 3 concerned permitted uses. It was not the proper place for the designation of the insured.

(c) At page 30 of their brief appellees state that appellant urges that "student instruction" and "training program" are synonymous terms. Before quoting further from appellees' comment it should be noted that the insurance company does not urge or advance any such contention. On the contrary, the insurance company has been at pains to point out the difference between the two terms (see op. br. pp. 16, 18). "Student instruction" would be a proper term to describe a single flight. This could not possibly be considered a "training program".

Returning to appellees' brief, they proceed (p. 31) to pose a series of rhetorical questions which are pertinent to the projected use of the aircraft. This has nothing to do with the definition of "insured".

Appellees' brief passes from one subject to the other and back again with the result that their argument is hopelessly confused. In doing so they completely misstate or misunderstand the contention of appellant. They say:

> Appellant would have this Court take an isolated, printed term from the omnibus clause—training program (which is not defined in application, policy, or dictionary and concerning which appellant submitted no evidence despite appellant's burden of proof), reject the fact determination by the trial court which is based upon the only evidence in the record, the evidence from Clark, and destroy or eliminate the uses expressly authorized by appellant in the declarations inserted by appellant by typewriter. (p. 33.)

The fact is that appellant's contention is the exact opposite. Appellant complains that the judgment against it is based on the theory that because the omnibus insured clause does not contain the same term "student instruction" as the use clause, the limitations of the omnibus clause should be disregarded. We do not ask that the omnibus clause be utilized to modify the permitted use.

We do not ask that it be utilized for any purpose except to define the category of those insured with the result that the clause does not extend its benefits to Clark because he was operating the aircraft under a training program.

4. Appellees' brief ignores the significance of the authorities cited in appellant's opening brief explaining the distinction between the provision as to permissive use and that as to the scope of the word "insured".

In section 1 of appellant's opening brief *Farm Bureau Ins. Co. v. Daniels,* 104 F. 2d 477 (4th Circ.) and *Standard Surety Co. v. Maryland Cas. Co.,* 119 N.Y. Supp. 2d 795, were analyzed.

Appellees (br. pp. 32-3) admit that in *Farm Bureau Ins. Co. v. Daniels* "the Court refused to use the omnibus clause, defining persons insured, to extend or broaden the uses defined in the declarations". Appellees then say: "We have no quarrel with that view". In that case appellees have in effect conceded the fallacy of the theory on the basis of which they persuaded the District Court to decide in their favor. They admit that "the omnibus clause" cannot be used "to extend or broaden the uses defined in the declarations". (br. pp. 32-3.) This principle must likewise operate in reverse. The use clause cannot be utilized "to extend or broaden" the scope of "the clause defining persons insured".

Appellees discuss *Standard Surety Co. v. Maryland Cas. Co.,* 119 N.Y. Supp. 2d 795 (br. pp. 33-4) but ignore that aspect of the decision which distinguishes between the object and effect of the two separate provisions of the policy.

The policy in the *Standard* case provided indemnity for personal injuries for which the insured was liable. But it excluded injuries to the insured's employees. The person injured was an employee. Hence, there was no coverage.

Appellees accurately describe the decision. But they ignore the effort of the employer to procure a different result by invoking the provision defining the "Insured". This was rejected by the court and the text of the opinion on this point is quoted at pages 10-11 of our opening brief. Appellees ignore it. But they say again that they "do not quarrel with this decision". (br. p. 33.) This again is a significant admission.

Appellees' brief does not mention that aspect of *Petro v. Ohio Cas. Co.,* 95 F. Supp. 59, in which—by way of dictum—the two clauses were confused. Appellees must be aware that it was on this dictum that Judge Jamison relied in emasculating the provision defining those insured by the policy. (See op. br. pp. 14-16.) Hence, appellees must be deemed to recognize the fallacy of *Petro* and likewise that of the decision at bar insofar as it is based on that case.

5. **Appellant does not contend—as appellees profess to believe —that Forhart was the only person insured by the policy.**

Forhart is not the sole insured. The omnibus clause includes others besides Forhart. This is demonstrated in appellant's opening brief, at pages 18-19. There are three separate categories—besides Forhart—of persons who could come within the scope of the omnibus clause. This was appellant's answer to the contention adopted by Judge Jamison that if the insurance company intended that Forhart was the only person contemplated by the term "the Insured" those precise words should have been incorporated in the omnibus clause.

Appellees' brief repeatedly advances the same contention. (pp. 9, 12, 29, 31.) It was anticipated in our opening brief.

The same comment is applicable to appellees' contention (br. pp. 13, 29) that the insurance company should have included in the omnibus clause the statement:

> The term "the Insured" does not include student pilots. Student pilots are not covered by this policy.

The answer is, as appears in appellant's opening brief (pp. 18-19), that a casual student pilot not engaged in a program would be an omnibus insured. Likewise, a student pilot—even though engaged in a program of instruction—would be an omnibus insured provided that no remuneration to Forhart was involved.

Appellees also suggest (br. p. 13) that the omnibus clause should have stated that "training program" includes any form of student instruction or that students receiving any form of student instruction are considered to be in a training program. The answer is the same and for the same reasons. A student receiving a single lesson in flying is not excluded. Likewise, one engaged in a regular course could not be excluded if he paid no remuneration.

Appellees (br. p. 29) even go so far as to assert that if the policy intended to insure Forhart alone it was required by Montana law "to expressly so state in plain, simple and unambiguous language. How extremely simple and easy it would have been to put this in the policy." The answer is again that this was not the intent of the policy.

6. "Training program" are words of ordinary usage in the English language. They require no definition nor amplification.

Having brushed aside all the confusing aspects of appellees' argument we reach the basic issue: What does "training program" mean and was Clark engaged in such a program?

Insurance policies are prepared for persons engaged in business. They are not morons. They are presumed to be of normal intelligence. That is all that is required in

order to understand the term "training program". These words are in ordinary usage.

Appellees also insist that the insurance company must introduce evidence of "the intent and meaning" of the words. (br. p. 29.) They persuaded Judge Jamison to rule accordingly. The point was anticipated in our opening brief. (pp. 14, 30.) An United States District Judge is as capable of comprehending the words of ordinary usage as any expert in philology. Subsequent to the preparation of our opening brief the case of *Lange v. Nelson Flight Service,* 108 N.W. 2d 428 (Minn.), came to our attention. There Lange held a commercial pilot's license. He desired to rent an airplane, and it was necessary that he make a checkout flight in the plane with an instructor before he was permitted to fly alone. Lang's status was described by the court as follows:

> The evidence is clear and uncontroverted that defendant, despite holding a pilot's license, had the status of a *trainee* during the checkout flight. (Italics supplied.) (p. 432.)

Another argument of appellees is that neither the dictionary nor Words & Phrases defines "training program". As to the dictionary, it customarily contains a definition of single words. Our opening brief (pp. 11-12) quotes the dictionary definition of the word "training". Appellees ignore this. A training program is a plan or course for the development of proficiency. That is precisely the activity in which Clark was engaged.

Appellees apparently concede that the dictionary may be consulted in order to ascertain the meaning of "training program". Our opening brief (pp. 13-14) cited two federal decisions in which the dictionary was used. One of them is *Insurance Co. of N.A. v. General Aviation Co.,* 283 F. 2d 590. Yet appellees say (br. p. 34): "We cannot see why appellant cites" this case. The reason is obvious.

As to Words & Phrases, the purport of appellees' argument is that unless on some previous occasion a court has been called upon to give effect to the words "training program" so that the definition appears in Words & Phrases, then it follows that when a court is called upon for the first time to give effect to the term it is barred from attributing to it its ordinary meaning in the English language. On its face, this contention is absurd.

Appellees also call attention to the fact that the Uniform Aeronautics Code adopted in Montana does not define "training program". (br. p. 21.) Appellees offer no reason why these words should appear in the Code at all.

Appellees mention (br. p. 30) various instances of training programs. This was anticipated in our opening brief. (pp. 16-18.) It was there demonstrated that Forhart's privately owned aircraft could not be used in connection with an official activity. He could engage only in private instruction. Furthermore, "any" program would include both private and public. This is exemplified in *Lambert v. New England Fire Ins. Co.,* 148 Me. 60, 90 Atl. 2d 451. (op. br. pp. 17-18.) Appellees mention *Lambert* saying that it "gives effect to a clearly expressed exclusion clause". (br. p. 34.) This, of course, ignores the pertinent aspect of the decision.

Appellees charge (br. p. 18) that the policy contains a "morass of ambiguous fine print clauses which not only conflict between themselves, but which contradict and conflict with the typewritten inserts." This complaint is unwarranted. There is nothing ambiguous about the words "training program"; there is no typewritten clause on the subject; there is nothing in the policy which conflicts with the provision containing the "Definition of Insured" and the print is plain and legible.

Appellees (br. pp. 23-4) cite *Holmstrom v. Mutual Benefit Health & Accident Ass'n,* 139 Mont. 426, 364 P.2d 1065, where the subject of fine print is mentioned. The issue there was whether a health and accident policy was cancellable. It contained a "Non-Cancellable Endorsement" providing against cancellation (p. 1066). This was printed in bold-faced type. (id.) In support of its asserted right to cancel the Mutual Benefit relied on another provision stating that "the acceptance of any premium on this policy shall be optional with the Association." (p. 1067.) The court rejected this contention holding:

> In our judgment this sentence is not consistent with the more boldly printed portions of the policy previously noted. It is not only ambiguous but conflicting. Here the appellant insured a man of forty-three, and continued to take his premiums for said insurance for a period of thirty-one years during which time he had no reason to believe that he did not have a non-cancellable policy. The time has passed when responsible insurance companies can hide, in the fine print, escape clauses that will leave responsible citizens uninsured in their senior years. (p. 1067.)

The foregoing demonstrates that *Holmstrom* is in no way pertinent to the case at bar.

7. There is no Montana statute or decision which supports appellees' effort to deprive the words "training program" of their plain and ordinary meaning.

Appellees assert (br. p. 28) that the law of Montana requires a definition "in plain, simple, unambiguous language" of the words "training program", if the insurance company "desired some specific application" of the term.* There is no such Montana law. This will be

*Appellees also contend (br. p. 28) that Montana law requires that an insurance policy contain a definition of "student", "student pilot", and "student instruction". This contention

demonstrated later by an analysis of the cases cited by appellees. It is only when an insurance company seeks to amplify the effect of a word, or to accord to a word some unusual meaning that the courts will decline to do so, unless the policy contains appropriate amplification. But they have consistently enforced words in ordinary use in an insurance policy.

There is nothing in the general rules of construction quoted from Montana statutes and decisions (appellees' brief, pp. 19-28) which prevents the application of the words "training program" to the course of instruction in which Clark was engaged, and there is no Montana case which even remotely bears on the problem at bar.

In the previous section we have analyzed and distinguished *Holmstrom v. Mutual Benefit Health & Accident Ass'n,* 139 Mont. 426, 364 P.2d 1065. (Appellees' br. p. 23.)

Appellees cite (pp. 21-3) *Park Saddle Horse Co. v. Royal Indemnity Co.*, 81 Mont. 99, 261 P. 880. There the insured was covered on account of liability "arising by reason of the maintenance and/or use of saddle and pack horses." The claimant was a member of a saddle horse party in Glacier Park. They became lost. The country was rugged and it was deemed necessary to dismount and proceed on foot. The claimant slipped and fell and suffered injuries. The court held:

> The entire transaction grew out of, and the accident happened on account of, or by reason of, the use of the horses, and it grew out of the use of horses in the operation of the insured's business. (261 Pac. 884.)

The decision contains nothing to assist the court in determining the meaning of a training program.

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borders on absurdity. However, these words are not involved in the controversy. There is no accountable reason for appellees' reference to them.

Next is *Montana Auto Finance Corp. v. British and Federal Underwriters,* 72 Mont. 69, 232 Pac. 198. (br. p. 24.) This case involved a confiscation bond issued to the owner of an automobile which was sold under a conditional sales contract. The bond provided indemnity against loss sustained as a result of confiscation by "municipal, Federal or state authorities."

The automobile was seized and confiscated by Canadian officers within the Dominion of Canada. The question was whether the Dominion of Canada could be deemed included within the scope of the term "municipal, Federal or state authorities." The court held in the affirmative relying on a provision in the British North America Act of 1867 to the effect that the provinces had "expressed their desire to be federally united into one dominion." The court also stated the general rule concerning interpretation in favor of the insured. The decision is entirely irrelevant to the issue at bar.

Next is *Johnson v. Continental Cas. Co.*, 127 Mont. 281, 263 P.2d 551. (br. pp. 24-6.) There an accident insurance policy covered injuries sustained from the wrecking of various kinds of vehicles including "motor-driven car, truck, wagon." It excluded "motorcycles and farm machinery." Johnson was fatally injured as the result of the overturning of a caterpillar tractor he was driving for the purpose of "skidding saw logs from the place where felled in the woods to the roadway where they could be loaded on motortrucks and hauled to the saw mill." (p. 551.) The court held:

> The contract used the terms "private commercial automobile," and "truck" and it is evident that by the use of the all-inclusive term "motor-driven car" the parties intended something more than what is usually denominated an automobile or a truck. This is further evidenced by the clause "(excluding motorcycles and farm machinery)". The only reasonable

> excuse for this exclusion clause is that without it the parties intended that motorcycles and all forms of motor-driven farm machinery would be included within the comprehensive classification of "motor-driven cars [or] trucks." Had defendant desired to exclude any other motor-driven vehicle than motorcycles and farm machinery it should have done so expressly. (p. 552.)

The case is not in point. The insurance company was striving for a strained and restricted construction which the language of the policy did not permit. This prompted the comment that if the company desired to exclude other motor-driven vehicles than those named, it could have done so.

Finally, appellees cite (pp. 26-8) *Keating v. Universal Underwriters,* 133 Mont. 89, 320 P.2d 351 (1958). There the policy insured a garage keeper against liability to others for damage to vehicles left in his charge. He had in his possession pursuant to a trust receipt an automobile the title to which was in General Motors Acceptance Corporation. The vehicle was in a wreck and the question arose whether the damage was covered. The insurance company resisted the claim on the ground that the policy contained an exclusion of property "owned" by the insured. The court held that the garage keeper was not the owner and therefore the insurance company was liable. Obviously, there was no sound reason for interpreting the words "owned" by the insured to include a vehicle held by the insured under a trust receipt. Thus, the court gave the word "owned" its ordinary meaning—just as in the case at bar the words "training program" must be given their ordinary meaning. The effort of the insurance company to expand the meaning of "owned" prompted the court to point out that it could have inserted in its policy language to the effect that the word "owned"

included vehicles which were floored or held under trust receipt.

The difference between *Keating* and the case at bar is clear. Appellant is not seeking to enlarge the meaning of "training program", but is content that it be given its ordinary significance.

Pages 36-7 of appellees' brief contain a list of twelve cases. Since no effort is made to explain them, appellees apparently attach little or no importance to them and no further comment is necessary in reply.

8. Appellees offer no answer to the apt description of a training program which is contained in Clark's explanation of his course of instruction.

In our opening brief (pp. 12-13) we quoted from Clark's response to a request for admission in which he described his agreement for instruction which contemplated hours of dual-time flying with Forhart and hours of solo time. This explanation constitutes a precise description of a training program. Appellees do not mention this portion of Clark's response. Obviously, they are unable to provide any answer. Likewise appellees ignore Clark's reference to his "solo flight training" in his statement, marked Exhibit 8. (See op. br. p. 12.)

All that appellees offer (br. p. 14) is another portion of Clark's response in which he gives his "understanding" of the meaning of a training program. This was anticipated in our opening brief. (p. 12.) It is the function of the court to determine the meaning of words in ordinary use. The "understanding" of a witness—particularly one who is an interested party—has no evidentiary effect.

9. The insurance company's payment of the hull damage was not an interpretation of the policy. It was a waiver of its right to resist the obligation. In any case it is not relevant to the definition of insured as applied to the facts of the case.

Forhart was the named insured. Hence, any payment of hull damage could not have any effect on the issue as to those who came within the category of "insured". Appellees apparently concede this and confine their contention to the issue as to permitted use under Item 7 of the Declarations which incorporates Endorsement Number 3.

Appellees' contention was anticipated in section 6 of our opening brief. (pp. 26-8.) Appellees' brief ignores this discussion. Instead of answering it appellees advance the contention (br. p. 11) that "by its conduct" the insurance company has interpreted the intent of the contract to mean that Clark was a permissible pilot. The answer is that the rule of practical construction of a contract applies to the conduct of the parties prior to the development of a controversy. When a dispute arises the rights of the parties are fixed. What the insurance company did after commencement of suit involves the matter of waiver. Despite their protest to the contrary, appellees are really contending that in paying the hull loss the insurance company deprived itself of its right to dispute Clark's status as a permitted pilot. But no matter whether practical construction or waiver is involved the fact remains that our opening brief adequately disposes of the point. And again appellees have ignored the discussion.

10. A flight involving a landing at a distant airport and an attempt to take off with three passengers without the knowledge of the instructor is not under his direct supervision and control.

Appellees devote four pages of their brief (pp. 7-11) to quotation of the provisions of the policy concerning permitted uses. They confess that "repeated reading by legally trained minds (presumably appellees' attorneys) compound confusion upon confusion". (p. 7.) We submit that this confusion is self-imposed. The learned District Judge—surely a trained legal mind—had no difficulty in analyzing the use clauses of the policy and ascertaining that instruction was permitted provided that it was under the direct supervision and control of Forhart. (See Tr. vol. 2, p. 50.)

Appellees' brief (pp. 15-16) quotes testimony of Clark and Lynch, and the statement of Clark. (Ex. 8.) This was discussed in our opening brief. (pp. 21-5.) Our analysis demonstrated that at the time of the crash the flight was not under the direct supervision and control of Forhart.

Appellees either misunderstand or misrepresent our contention. Referring to Clark's statement and testimony they assert:

> Appellant suggests the District Court should have disbelieved this evidence. (p. 16.)

No such suggestion has been made. No question of credibility is involved. The ground of appeal now under discussion is that assuming the truth of all the testimony favorable to appellees the only possible conclusion to be drawn is that Clark was not under the direct supervision and control of Forhart at the time of the crash.

The same misconception appears in appellees' assertion (br. p. 17) that appellant "objects because the District

Court considered and believed all of it (Lynch's testimony) along with Clark's corroborating evidence'' and again in appellees' argument (p. 15) that the trial judge observed Clark's ''manner, appearance, and the like''.

The insurance company had the right to insist on direct supervision and control during a flight by a student—a requirement which was necessarily breached when Clark undertook a flight to a distant airport. Forhart's permission could not bind the company.

Appellant's opening brief (p. 25) points out the contradictory aspect of the decision below holding that appellant must pay claims made against Lew Chevrolet Co. That company can be held liable only on the theory of respondeat superior as the employer of Clark. A condition precedent to this ruling is that Clark was acting in the scope of his employment—that is, that he was engaged in selling an automobile. On that hypothesis Clark was not taking instruction and the use of the aircraft was not permitted. Appellees' brief ignores the point again recognizing that it is unanswerable.

Dated, San Francisco, California,
March 5, 1964.

Respectfully submitted,
David Livingston,
Attorney for Appellant.

(Appendix Follows)

Appendix.

Appendix

Schedule of Exhibits: Reference to Record

Exhibit No. 7—Telegram ..............T.R. Vol. 1 p. 2

Exhibit No. 8—Statement of Clark .....T.R. Vol. 1 pp. 15, 17

IN THE

United State Court of Appeals

FOR THE NINTH CIRCUIT

MEYER FELDMAN,
Appellant,

vs.

WILSON B. WOOD,
District Director of Internal Revenue for Arizona,
Appellee.

No. 18,908

On Appeal From the Judgment of the United States District Court for the District of Arizona

BRIEF FOR THE APPELLANT

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II. The record establishes that in any event taxpayer was entitled to a depreciation deduction in the sum of $47,300.00 under the terms of Section 167 of the Internal Revenue Code and Treasury Regulations. 1.167(a) for the abnormal retirement of depreciable assets during 1957 ..... 5, 22

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IN THE

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 18,908

MEYER FELDMAN,
Appellant,

vs.

WILSON B. WOOD,
District Director of Internal
Revenue for Arizona,
Appellee.

On Appeal From the Judgment of the United States District Court for the District of Arizona

BRIEF FOR THE APPELLANT

OPINION BELOW

The findings of fact and conclusion of law of the District Court (R.I. 14-18) are reported in 1963 - 1 U.S.T.C. 9428.

JURISDICTION

This suit was commenced against the District Director of Internal Revenue for Arizona based upon his denial of a timely filed claim for refund. (R.I. 8) The judgment appealed from was entered April 11, 1963 (R.I. 20), and the notice of appeal (R.I. 21), was filed June 10, 1963. The jurisdiction of this Court rests on 28 U.S.C. 1291.

QUESTION PRESENTED

Whether taxpayer, whose lessee demolished valuable improvements situated on the leased property, is entitled to claim a deduction under Section 165 or 167 of the Internal Revenue Code of 1954 for cost basis of such demolished improvements.

STATUTES AND REGULATIONS INVOLVED

Appendix A *infra*.

STATEMENT

Taxpayer, in 1950, purchased business property in downtown Tucson, Arizona. The property was improved with a residential court and warehouse. Taxpayer moved the residential court to other property owned by him, and continued to rent the warehouse under the same terms as the previous owner. (R.II. 51.) On June 8, 1951, taxpayer entered into a five-year lease (with a five-year option), to lease the property (excluding the warehouse) to M. V. and Geneva R. Blakely. The Blakely lease required taxpayer to construct a filling station (R.I. 12), which he did. (R.II. 19-20.)

Taxpayer's wife died in 1953 and the subject property acquired a new cost basis as follows, (R.I. 9):

Buildings	-	$55,000.00; and
Land	-	$45,000.00.

On June 1, 1955, taxpayer entered into a 99-year lease of all of the subject property with Laurence D. and Pauline Mayer. (R.I. 9.) The Mayers, in August of 1957, demolished the warehouse and filling station, which at the time had an unrecovered cost basis of $47,300.00. (R.I. 9.)

Taxpayer filed his 1957 individual Federal income tax return, claiming a depreciation deduction of $48,-400.00 for the unrecovered cost basis of the warehouse

and filling station. (The $1,100.00 difference results from allowable but unclaimed depreciation). Appellee's examining revenue agent disallowed the claimed deduction, and based upon this disallowance (and minor adjustments not here in issue), Appellee assessed against taxpayer $29,558.32 in tax deficiencies and interest for calendar year 1957. (R.I. 8.) Taxpayer paid the above sum to Appellee on August 8, 1961, and thereafter timely filed a claim for refund and upon its denial this lawsuit. (R.I. 8.)

Taxpayer in his claim for refund made the following contentions, (R.I. 4-5):

(1) He suffered a tax deductible loss in the claimed amount under Section 165 of the Internal Revenue Code of 1954, for the demolition by lessee, Mayer, of his warehouse and filling station.

(2) He was entitled to a depreciation deduction in the claimed amount under Section 167 of the Internal Revenue Code of 1954, for the retirement from useful life during 1957, of the subject buildings.

SPECIFICATION OF ERRORS RELIED ON

1. The District Court erred in finding and concluding that taxpayer suffered no loss within the meaning of Section 165 of the Internal Revenue Code, when his lessee demolished buildings with an adjusted cost basis of $47,300.00.

2. Regulation 1.165-3(b)(2) denies a loss when the demolition is pursuant to the *requirements* of a lease. Taxpayer's lease permitted demolition, it did not *require* it. The District Court erred when it failed to apply this Regulation to facts of the case.

3. The District Court erred in concluding that Treasury Regulations 1.165-3(b)(2), though promul-

gated by the Commissioner of Internal Revenue, were not binding on the Government in this case.

4. The District Court erred in finding and concluding that taxpayer was not entitled to a depreciation deduction within the meaning of Section 167 of the Internal Revenue Code when the useful life of depreciable assets with an adjusted cost basis of $47,-300.00 was suddenly terminated.

5. The District Court erred in finding and concluding that Treasury Regulation 1.167(a)-8, allowing a deduction for the abnormal retirement of a depreciable asset, had no application to the sudden redetermination of useful life of taxpayer's depreciable assets through his lessee's demolition of such assets.

6. The District Court erred in finding that taxpayer had failed to meet his burden of proving a loss deduction in calendar year 1957.

7. The District Court erred in finding that taxpayer had failed to meet his burden of proving a depreciation deduction in calendar year 1957.

SUMMARY OF ARGUMENT

Treasury Regulation 1.165 interpreting the 1954 Code, allows a taxpayer a loss deduction for the demolition of buildings on income producing property where the intent to demolish is formed subsequent to the date of acquisition. For property under lease the deduction is denied only where the demolition is pursuant to the *requirements* of the lease. Taxpayer's lessee, in 1957, demolished buildings with an unrecovered cost basis to taxpayer of $47,300.00. Taxpayer acquired the property in 1950, and leased it in 1955. The lease did not require demolition, but permitted it.

Treasury Regulation 1.167 interpreting the 1954 Code, allows a loss (or gain) for the permanent with-

drawal of depreciable property from use in a trade or business by "abnormal retirement." Abnormal retirement means the withdrawal of the asset for a cause not contemplated when setting the applicable depreciation rate. Taxpayer's situation here is precisely within the terms of this Regulation.

ARGUMENT

I.

THE RECORD ESTABLISHES THAT TAXPAYER WAS ENTITLED TO A DEMOLITION LOSS FOR CALENDAR YEAR 1957 IN THE SUM OF $47,300.00 UNDER THE TERMS OF SECTION 165 OF THE INTERNAL REVENUE CODE AND TREASURY REGULATIONS 1.165-3, PROMULGATED PURSUANT TO THAT SECTION AND CONSISTENT THEREWITH.

Taxpayer-Appellant acquired the subject property in 1950, along with a warehouse and rental units. In the purchase of the property, he executed two mortgages, in each of which there was a provision allowing him to remove existing buildings. (R.I. 11.) Taxpayer removed the rental units, but continued to rent the warehouse. He had intended to remove the rental units when he purchased the property, and he had intended to continue to rent the warehouse. (R.II. 52.) The rental units were removed, and their removal is not in issue here. The issue here is the demolition of the warehouse and a subsequently constructed filling station. The demolition took place some seven years after the date of purchase of the property.

The subject filling station was not constructed until after taxpayer had acquired the property, and it

was, from the time of construction, subject to the five-year Blakely lease and the five-year renewal option of such lease. (R.I. 12.) The warehouse was separately rented at the time of acquisition, and taxpayer continued to rent it to the then tenant, and others, for a period of seven years. (R.II. 52.) Treasury Regulations 1.165-3(b), Appendix A, *infra*, provides in part:

(1) "* * * the loss incurred in a trade or business in a transaction entered into for profit and arising from a demolition of old buildings shall be allowed as a deduction under 165(a) *if the demolition occurs as a result of a plan formed subsequent to the acquisition of the building demolished.* * * * " (underscoring supplied).

This Regulation and preceding Rulings represent the Appellee's recognition of a long line of cases. See I.T. 3311, 1939 - 2 Cum. Bull. 206; *Union Bed & Spring Co. v. Commissioner*, 39 F.2d 383 (C.A. 7th) reversing 9 BTA 352; *Panhandle State Bank v. Commissioner*, 39 T.C. 813; *George S. Gaylord v. Commissioner*, 3 T.C 281; aff'd on other grounds, 153 F.2d 408 (C.A. 9th); *Wearley v. U.S.*, 32 A.F.T.R. 1761 (D.C. N.D. Ohio); *Hotel McAllister, Inc. v. U.S.*, 3 Fed. Supp. 533 (D.C. Fla.).

The buildings in question were demolished by the subsequent lessee, Mayer, in 1957, and they had been held up to that time in taxpayer's trade or business. (R.I. 9.) The only remaining question is whether taxpayer is within the exclusion to the above Regulation which provides 1.165-3(b)(2), Appendix A, *infra*:

"If a lessor or lessee of real property demolishes the buildings thereon pursuant to the requirements of a lease * * * no deduction shall be allowed. * * *"

The lease in question provides, (R.I. 9; stip. Ex. C):

"11. Lessee shall have the right to remove and demolish any or all existing improvements on the demised premises for the purpose of creating additional parking area, adding improvements, or providing ingress and egress to and from Toole Avenue, * * *."

This language seems clear. Lessee, Mayer, may demolish — he is not required to do so. The permissive nature of lessee Mayer's rights with regard to the lease, is again emphasized in paragraph 22 of the lease. (R.I. 9; stip. Ex. C):

"22. The lessee may, at any time or times during the term hereof, and at his own cost and expense, make any alterations, rebuildings, replacement, changes, additions and improvements to the demised premises * * *."

The term "require" or "requirement" has a common and definite meaning to lawyers and to laymen alike.

Black's Law Dictionary (Third Ed.):

Require: To direct, order, demand, instruct, command, claim, compel, exact. /Citations/

Webster's Third New International Dictionary, 1961 Ed.:

Requirement: * * * something required.
a: Something that is wanted or needed: *Necessity.*
b: Something called for or demanded: a requisite or essential condition. * * *

In addition, the term "require" or "requirement" has been defined in innumerable cases. A few of these are:

The word require means to demand; to ask as of right and by authority; to insist on having; to exact. *Federal Lead Co. v. Swyers,* 161 F. 687, 692.

Require is synonymous with demand. *U.S. v. Armour & Co., et al.,* 142 F. 808, 822.

Requirement is defined as being that which is required: An imperative or authoritative command. *Ohio Automotive Sprinkler Co. v. Fender,* 141 N.E. 269, 275; 108 Ohio St. 149.

To require means to demand. *State, ex. rel. Frohmiller,* 124 P.2d 768, 773; 59 Ariz. 184; see also *Industrial Commission v. Frohmiller,* 140 P.2d 219, 222; 60 Ariz. 464.

The normal meaning of the word require means to demand: to claim as by right and authority; to exact. *Harwood v. Dysart Consolidated School* Dist., 21 N.W.2d 334, 336; 237 Iowa 133; *Newcomb v. Victory Ins. Co.,* 155 P.2d 456, 458; 159 Kan. 403.

Taxpayer, here, could not compel or demand any demolition. Under the terms of this lease, the lessee could have been in possession for 99 years and not demolished anything. Requirement may be used in the permissive sense — such as a contract which provides that "the lessee may cut sufficient timber to meet his requirements." It is clear, however, that the Commissioner in the instant case did not use the word in the permissive sense. His proposed Regulation (Proposed January 3, 1956, withdrawn and proposed again October 8, 1959), read as follows, 1.165-3(2)(d):

> "(d) *Buildings demolished to obtain lease.* If pursuant to the *terms* of a lease, the lessor of real property demolishes buildings situated thereon, no deduction shall be allowed to the lessor under 165(a) on account of the demolition of the old buildings. Likewise, if, pursuant to the *terms* of a lease, the lessee of real property demolishes the buildings, no deduction shall be allowed to the lessor * * *." (underscoring supplied).

The use of the word "terms" of course, would be

permissive and if the Commissioner had enacted his final regulation using "terms," we would have little to argue. However, the Commissioner, after inviting comments on the proposed Regulation and after months and months of careful consideration, changed the word "terms" to "requirements." There is no other fair conclusion to draw from the Commissioner's voluntary changing of the wording of this Regulation, but that it was his intent that the loss should be excluded when demolition is compelled or required by the lease, but not when it was merely permitted. Fortunately, we do not need to speculate on the Government's intention in this regard, for the Commissioner invited comments on his October 8, 1959, proposed Regulation.

On October 22, 1959, taxpayer's accountants forwarded the following comment to the Commissioner on his proposed Regulation, (R.I. 10):

"Commissioner of Internal Revenue
Washington, D.C.

Subject: *Comment on Proposed Regulations* 1.165-3(d)

Sir:

Pursuant to the Administrative Procedure Act of 1946, we hereby urge, on behalf of our clients and in the interests of administrative clarity, that the proposed regulations 1.165-3(d) (published 10/8/59) be reworded to read substantially as follows:

> If, pursuant to the *requirements* of a lease, the lessor of real property demolishes buildings situated thereon, no deducton shall be allowed to the lessor under section 165(a) on account of the demolition of the old buildings. Likewise, if, pursuant to the *requirements* of a lease the lessee of real property demolishes the buildings, no deduction shall be allowed to the lessor. However, the adjusted basis of the demolished building shall

be considered as a part of the cost of the lease to be amortized over the term thereof.

The regulation as published in the Federal Register, has the word *terms* where we have above inserted *requirements.*

ARGUMENT

A long line of cases (of which the most recent is *Estate of Clara Nickoll,* 32TC132) has held that where buildings are demolished as a condition of obtaining a lease, the unrecovered cost of such buildings is in reality part of the cost of the lease so obtained. The proposed regulation, due to the possible vagueness of meaning of "pursuant to the terms" could conceivably extend this rule to almost all demolitions.

1. Almost all commercial property is occupied under some form of lease. If, during the period of a lease, a demolition takes place, then such demolition either violates the lease or is presumably "pursuant to the lease," at least as modified at that point by the parties. If the demolition violated the lease, the demolition could be enjoined by the injured party, in which event it would never occur. If it does not violate the lease, it must be "pursuant to the terms" of the lease.

2. It is not uncommon for long term leases to contain clauses whereby the lessee is permitted to demolish any improvements. If a piece of property was leased on a ninety-nine year lease, for example, the lessee would normally, as a matter of routine, be granted this right — which might be exercised in five, or fifteen, or fifty years. Such a clause would be for the purpose of protecting the lessee, and would not evidence any specific intent of the parties to demolish at any specific time, or even at all. It would normally not be a factor in determining the rental terms. As to this point, see the attached letter from Dr. James Chase. Since the year 1950, Dr. Chase has been regularly listed in Who's Who, and also in American Man of Science. Please note attached summary of his professional status. In our opinion, he is a highly quali-

fied expert in this field, with over twenty years of teaching and consulting experience.

3. The proposed regulation seeks to disallow a loss where the parties, at the time of entering into the lease and as a part of the consideration for entering into the lease, contemplate and contract to have such demolition take place. In this sense, the proposed regulation is within the spirit of I.T.3311, CB206, 1939-2. There the position was set forth that if specific intent to demolish was present at the time of acquiring the property, the loss should be disallowed. This reasoning is reiterated in proposed Regulation 1.165-3(b). But this reasoning is best exemplified in this area if the proposed wording is changed to "pursuant to the requirements of a lease," rather than "pursuant to the terms of a lease," since "terms" could be merely permissive as well as mandatory, and could be implied as well as explicit.

Respectfully submitted,

/s/ Jacob Smith
Jacob Smith, C.P.A.
Enrolled to practice before the
Treasury Department."

It should be noted that taxpayer's representatives pointed out to the Commissioner that the use of the phrase "pursuant to the terms of a lease" could only mean permissive demolition and that the net practical effect of this language would be to deny a demolition loss in any long term lease. The comment further notes that a long term lease almost of necessity permits demolition but it does not of necessity compel it.

The Commissioner not only acknowledged the comment, but changed the Regulation and expressed his appreciation for the suggestion, (R.I. 10):

"Goldstein, Kramer and Smith
2221 East Broadway — Nov. 20, 1959
Tucson, Arizona

Attention: Mr. Jacob Smith

Gentlemen:

This will acknowledge your letter dated October 22, 1959, commenting on the provisions of proposed regulations under the internal revenue law which were published in the Federal Register for Thursday, October 8, 1959.

Your comments are appreciated and will be given careful consideration before the final regulations are promulgated.

Very truly yours,

(signed)

Chief
Regulations Program Section"

"Goldstein, Kramer and Smith
2221 East Broadway
Tucson, Arizona

January 15, 1960

Attention: Mr. Jacob Smith

Gentlemen:

This is in further reply to your letter of October 22, 1959, regarding the proposed regulations issued under section 165 of the Internal Revenue Code of 1954, relating to deduction for losses.

The final regulations on deduction for losses have been promulgated as Treasury Decision 6445. This Treasury Decision will be published in the issue of the Federal Register for Saturday, January 16, 1960. It reflects a number of changes from the proposed regulations previously published.

Your interest in submitting comments on the proposed regulations is appreciated.

Very truly yours,

(signed)

Director
Technical Planning Division"

The Commissioner made this change with full knowledge of the comment and his prior rulings denying a deduction when demolition is compelled. The comment pointed out the theory behind these rulings was that when demolition is required it is usually negotiated for by the parties and becomes part of the consideration for the lease, (accountants' letter of October 22, 1959, *supra*).

We do not say that these events result in a legal or equitable estoppel of the Commission, but we do say he cannot now claim he did not intend the mandatory or compelling meaning of the term "requirement." He cannot now say that "require" really does

not mean "require." If he truly intended that the regulation should be interpreted as he now contends, then he should have stayed with his original language.

As previously noted in this brief (p. 8-13), the Commissioner gave careful and unhurried consideration to this Regulation before its final adoption. It is submitted that he is bound by his Regulation. The general rule as to administrative construction applied to the Commissioner, as well as other administrative agencies, that is:

> The administrative interpretation does not necessarily control the court's decision as to the proper construction of a statute, but generally or in particular circumstances it is given great weight and has a very persuasive influence, and may actually be regarded by the court as the controlling factor, since in doubtful cases there is an inclination to adopt the administrative construction which in any event will not be disturbed except for very cogent and persuasive reasons and a clear conviction of error. *Commissioner v. South Texas Lumber Co.,* 333 U.S. 496 (must be sustained unless unreasonable and plainly inconsistent with the statute); *United States v. Leslie Salt Co.,* 350 U.S. 383, 389 (* * * the Treasury's interpretations of it are entitled to great weight); *White v. Winchester Country Club,* 315 U.S. 32, 41 (* * * they are entitled to serious consideration * * *); *United States v. Wyoming,* 331 U.S. 440; *Lucas v. American Code Co.,* 280 U.S. 445.

We do not believe the Government can contend that because the events in question took place prior to its adoption, this Regulation has no application to the present case: Section 7805(b) of the Internal Revenue Code (Appendix A, *infra*) provides in part:

> "Sec. 7805 *Rules and Regulations*
>
> * * *
>
> "(b) Retroactivity of Regulations and Rulings.—The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation, relating to the Internal Revenue laws shall be applied without retroactive effect."

Congress has by this statute given to the Commissioner an election. He may elect to specifically provide that a Regulation shall not be applied retroactively. He has not done so in the instant case and he is bound by his choice. No other rule could prevail, for if this were not so, there would be nothing to prevent Government counsel (where it suited the revenue) from arguing for example, in a Texas Federal District Court, that this Regulation has retroactive effect.

It should also be noted that while an administrative agency may amend or rescind its rules and regulations, so long as a rule or Regulation remains in force and without change, the agency is as much bound by such rule as the public to whom it is directed. The Regulation may not be ignored by the agency or suspended in a particular case. *Columbia Broadcasting Co. v. U.S.*, 316 U.S. 407; *Farmers Co-op v. Commissioner,* 288 F.2d 315 (C.A. 8th); *American Broadcasting Co. v. Federal Communications Commission,* 179 F.2d 437 (C.A. D.C.); 165 ALR 816.

The Mayer lease provided that some time during its ninety-nine ear term, the lessee would construct improvements of not less than $75,000.00. (R.I. 9.) From this, the Government may attempt to argue that demolition was implied. Outside of the fact that "implied" demolition could not under any circumstances be construed to be "required" demolition, the physical char-

acteristics of the property in question would have allowed lessee, Mayer, to construct a $75,000.00 improvement, or for that matter a $750,000.00 improvement, without disturbing any of the existing structures, (R.II., Ex. 1 & 2), and, the Court took judicial notice of this fact. (R.II. 27.)

The Government in seeking to avoid its present Regulation, relies on *Young* v. *Commissioner*, 59 F.2d 691 C.A. 9th), and *Blumenfeld Enterprises, Inc.* v. *Commissioner*, 23 T.C. 665, aff'd per curiam 232 F.2d 396 (C.A. 9th). These cases were decided under Regulations which did not specifically cover the lessor-lessee situation. In addition they involved significant factual differences and as the Court states in *Young*, "Each case is left to be judged on its own facts." In *Young*, the 99 year lease required the erection of a business building which in turn *required* demolition. The lease of existing buildings and the demolition occurred in the same year and it is clear that this immediate demolition was part of the consideration for the lease and had a direct relationship to the rental rate. The Court stated (59 F.2d 691 at 692 and 693):

> " * * * On the other hand, where he finds its advantageous to remove substantial buildings in order *to secure a lease* which will result in his having erected on his property a new building, without money outlay on his part for its construction, and to have assured a large rental income for a long term of years, it would seem just and reasonable that the value of the buildings removed be charged as a contribution to the cost of securing his lease, and as a part of the investment then made for that purpose."
> (emphasis supplied.)

In the instant case, demolition was not implicitly or explicitly required, and did not in fact occur until

over two years after the lease agreement. While demolition was permitted in the Mayer lease, there is no showing that it was part of the consideration or affected the rental rate. In addition the Court in *Young* assumed the lease had a pecuniary advantage and benefit to the lessor. This was not true of the Mayer lease.

The facts in *Blumenfeld* differ significantly from the instant case. The lease involved a theater building, but it also specifically required the building to be remodeled and the premises used for parking. The lessee was unable to get the San Francisco authorities to approve his remodeling plans. The items they required raised the cost to such a level that demolition of the building and use of the land for surface parking seemed more economical. Therefore *prior* to the effective date of the lease, a letter contract was entered into. This agreement required lessee to demolish the building, and demoltion actually took place immediately thereafter. The contract further provided as follows:

> (23 T.C. 665, 667):
>
> "5. In the event the Purchaser does not conclude the purchase of the property within one (1) year, the $25,000.00 mentioned under #2 above shall remain with the Seller as additional lease deposit under that certain lease dated the 6th day of October, 1949, between Blumenfeld Enterprises, Inc., as lessors, and Harry Morofsky, as lessee, and shall be deducted from rentals at the end of the lease term. In consideration of this additional lease deposit, the lessors grant to the lessee permission to demolish the rear portion of the premises (theater building) for the purposes conforming to said lease and further provided the lessee shall furnish to the lessor modified plans showing the proposed basement and ground floor development and shall secure from the lessors written permission for said development. All of the cost of demolishing and

improving shall be at the lessee's sole cost and expense."

It is clear from this agreement that immediate demolition was contemplated and that lessor negotiated for, and received compensation for such demolition. The Court states, 23 T.C. 665, 671:

> "* * * To be sure, the demolition of the theater building was not contemplated at the time of the execution of the agreement of October 6, 1949, but, prior to the commencement of the lease (May 1, 1950), it has become abundantly clear that the entire purpose of the lease would be defeated unless the building were demolished. * * *"

If *Blumenfeld* is viewed in its practical aspect — which is that of a sale — with demolition contemplated at the time of the sale, it followed under the Regulations in effect then (Reg. 111, Sec. 29.23(e)-2 and would also follow under present Regulations 1.165-3(a)) that no deduction is allowable for the latter Regulation states:

(1) " * * * the following rule shall apply when, in the course of a trade or business . . . real property is purchased with the intention of demolishing immediately or subsequently the buildings situated thereon: No deduction shall be allowed under Section 165(a) * * *."

These are not the facts of the instant case.

In *Blumenfeld,* it is further stated (23 T.C. 665, 671):

> "Finally, the deduction must be disallowed for the reason that the removal of a building in connection with obtaining a lease on the property is regarded as part of the cost of obtaining the lease. (citing cases)"

This rule can have no application to this taxpayer since, under his lease, the removal was not connected

with obtaining the lease, and in fact, under the terms of the lease, removal might never occur.

II

THE RECORD ESTABLISHES THAT IN ANY EVENT TAXPAYER WAS ENTITLED TO A DEPRECIATION DEDUCTION IN THE SUM OF $47,300.00 UNDER THE TERMS OF SECTION 167 OF THE INTERNAL REVENUE CODE AND TREASURY REGULATIONS 1.167(a) FOR THE ABNORMAL RETIREMENT OF DEPRECIABLE ASSETS DURING 1957.

Treasury Regulations 1.167(a)-8(a)(3) (Appendix A, *infra*) allows a loss deduction for the abnormal retirement of an asset.

Section 1.167(a)-8(b) of the same Regulation defines abnormal retirement. A retirement will be considered normal unless the taxpayer shows that the withdrawal was due to a course not contemplated in setting the applicable depreciation rate. Stated positively the Regulation further states that a retirement may be abnormal if the asset is withdrawn at a time earlier than the normal range of years taken into consideration in fixing the depreciation rate.

The applicable depreciation rate for these buildings was set in 1953 at a rate based upon a 25 year life. (R.I. 8-9.) ($55,000.00 × 4% = $2,200.00 per year for 25 years). In 1953 the property was subject to the 1951 Blakely lease which had three years to run on the original lease, and five years on the option. (R.I. 12.) The Blakely lease did not contain a demolition clause or any other clause contemplating an early retirement of the leased buildings. The 25 year life was within the normal range for this type of building. *H. K. Jackson* v. *Commissioner*, 20 T.C.M. 1126; *J. D. O'Connor* v.

Commissioner, 13 T.C.M. 623; *Missouri State Life Ins. Co.* v. *Commissioner,* 29 BTA 401. The fact that Mayer, under a 99-year lease signed in 1955, might demolish or suddenly terminate the useful life of these buildings, could not have been contemplated by anyone in 1953.

The useful life of these buildings on January 1, 1957, was 21 years. The useful life of these buildings on December 31, 1957, was zero. The assets were withdrawn for a cause not contemplated in setting the rate any earlier than the normal range of years contemplated in fixing the rate. The retirement was abnormal within the terms of the Commissioner's Regulation. This Regulation was proposed November 11, 1955, and adopted June 11, 1956, by Treasury Decision 6182. The same arguments regarding the force and effect of the demolition Regulation (*Brief Supra* p. 14, 15) apply to this Regulation. While this Regulation did not exist under the 1939 Code, the principle it seeks to apply is not new.

The pattern of taxation in regard to depreciable property involves the writing-off of cost. A taxpayer estimates the useful life of property and its probable salvage value at the end of that life, and thereafter, until the situation changes proceeds to compute his annual depreciation on the basis of these assumptions. When the situation has so changed that the useful life of the property to the taxpayer has been redetermined, then a final adjustment of depreciation becomes necessary. Demolition is such a redetermination. See *Cosmopolitan Corporation* v. *Commissioner,* 1959 T.C. Memo 122; *Raymond L. Klinck* v. *Commissioner,* 11 T.C.M. 1224. Depreciation is to be determined according to circumstances as they are known to exist at the end of the subject year. *Rayville Coal Co.* v. *Commissioner,* 20 BTA 525, a decision in which the Com-

missioner acquiesced and *Sample - Durich Co.* v. *Commissioner*, 35 BTA 1186.

The trial court stated on this issue (Finding of Fact 11, R.I. 18):

> "When the buildings were demolished they had a useful life for a substantial number of years in the future, * * *."

The trial court has apparently confused useful life with physical or economic life. Physical or economic life is not the proper criteria for fixing depreciation; useful life is. *The Hertz Corporation* v. *U.S.*, 364 U.S. 122; *Massey Motors, et al.* v. *U.S.*, 364 U.S. 92.

There is no dispute that the buildings in question were in excellent physical shape, but this has nothing to do with Section 167 and useful life. It is the taxpayer's contention that the useful life of these buildings was redetermined in 1937. Treasury Regulation 1.167(b)-(0) provides as follows:

> "(a) * * * The reasonableness of any claim for depreciation shall be determined upon the basis of conditions known to exist at the end of the year for which the return is made. It is the responsibility of the taxpayer to establish the reasonableness for the depreciation claimed. Generally, depreciation deductions so claimed will be charged only where there is a clear and convincing basis for a charge."

Demolition is a clear and convincing basis for an adjustment to useful life. Under the theory of each tax year standing on its own, the adjustment must take place in the year of final determination of useful life. *C. Cohn* v. *U.S.*, 259 F.2d 371 (C.A. 6th).

In *H. A. Kuckenberg* v. *Commissioner*, 35 T.C. 473, a corporation made a liquidating distribution of its assets to its stockholders, who, in turn, transferred the

assets to their new partnership. A reappraisal of the assets by the partnership led to extended lives for assets. The Commissioner contended the corporation must, on its final return, use such extended lives. The Tax Court agreed and its reasoning was based on the fact that at the time the accountant prepared both the corporate and partnership returns, he knew the assets had a longer useful life than originally estimated in earlier corporate returns, and he should have made an adjustment extending the life. If such an adjustment is necessary when it suits the revenue, then it must be equally necessary when it does not.

From facts known at the end of 1957, taxpayer knew that the remaining useful life of this depreciable property was zero, and he was entitled to recover the balance of his cost basis in that year.

CONCLUSION

For the reasons stated, it is respectfully submitted that the decision of the trial court was erroneous and should be reversed.

Respectfully submitted,

DAVID W. RICHTER,
Tucson, Arizona

Of Counsel:

WHITEHILL, FELDMAN & SCOTT
Phoenix Title Building,
Tucson, Arizona.
February, 1964
Tucson, Arizona

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

DAVID W. RICHTER,
Attorney

APPENDIX A

STATUTES INVOLVED

Internal Revenue Code of 1954:

Sec. 165, LOSSES.

(a) GENERAL RULE — There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(b) AMOUNT OF DEDUCTION — For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

(c) LIMITATION ON LOSSES OF INDIVIDUALS — In the the case of an individual, the deduction under sub-section (a) shall be limited to — (1) losses incurred in a trade or business. * * * (26 U.S.C. 1958 ed., Sec. 165)

Sec. 167. DEPRECIATION.

(a) GENERAL RULE — There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) — (1) of property used in the trade or business, or (2) of property held for the production of income.

* * *

(g) BASIS FOR DEPRECIATION — The basis on which exhaustion wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided

in section 1011 for the purpose of determining the gain on the sale or other disposition of such property. (26 U.S.C. 1958 ed., Sec. 167)

Sec. 7805. RULES AND REGULATIONS—

* * *

(b) RETROACTIVITY OF REGULATIONS OR RULINGS — The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect. (26 U.S.C. 1958 ed., Sec. 7805)

TREASURY REGULATIONS ON PROCEDURE AND ADMINISTRATION (1954 CODE):

Reg. §1.165-3 (T.D. 6445, filed 1-15-60) DEMOLITION OF BUILDINGS.

(a) *Intent to demolish formed at time of purchase.*

(1) Except as provided in subparagraph (2) of this paragraph, the following rule shall apply when, in the course of a trade or business or in a transaction entered into for profit, real property is purchased with the intention of demolishing either immediately or subsequently the building situated thereon: No deduction shall be allowed under section 165(a) on account of the demolition of the old buildings even though any demolition originally planned is subsequently deferred or abandoned. The entire basis of the property so purchased shall, notwithstanding the provisions of §1.167(a)-5, be allocated to the land only. Such basis shall be increased by the net cost of demolition or

decreased by the net proceeds from demolition.

(2) (i) If the property is purchased with the intention of demolishing the buildings and the buildings are used in a trade or business or held for the production of income before their demolition, a portion of the basis of the property may be allocated to such buildings and depreciated over the period during which they are so used or held. The fact that the taxpayer intends to demolish the buildings shall be taken into account in making the apportionment of basis between the land and buildings under §1.167(a)-5. In any event, the portion of the purchase price which may be allocated to the buildings shall not exceed the present value of the right to receive rentals from the buildings over the period of their intended use. The present value of such right shall be determined at the time that the buildings are first used in the trade or business or first held for the production of income. If the taxpayer does not rent the buildings, but uses them in his own trade or business or in the production of his income, the present value of such right shall be determined by reference to the rentals which could be realized during such period of intended use. The fact that the taxpayer intends to rent or use the buildings for a limited period before their demolition shall also be taken into account in computing the useful life in accordance with paragraph (b) of §1.167(a)-1.

(ii) Any portion of the purchase price which is allocated to the buildings in accordance with

this subparagraph shall not be included in the basis of the land computed under sub-paragraph (1) of this paragraph, and any portion of the basis of the buildings which has not been recovered through depreciation or otherwise at the time of the demolition of the buildings is allowable as a deduction under section 165.

(iii) The application of this subparagraph may be illustrated by the following example:

Example. In January, 1958, A purchased land and a building for $60,000 with the intention of demolishing the building. In the following April, A concludes that he will be unable to commence the construction of a proposed new building for a period of more than 3 years. Accordingly, on June 1, 1958, he leased the building for a period of 3 years at an annual rental of $1,200. A intends to demolish the building upon expiration of the lease. A may allocate a portion of the $60,000 basis of the property to the building to be depreciated over the 3-year period. That portion is equal to the present value of the right to receive $3,600 (3 times $1,200). Assuming that the present value of that right determined as of June 1, 1958, is $2,850, A may allocate that amount to the building and, if A files his return on the basis of a taxable year ending May 31, 1959, A may take a depreciation deduction with respect to such building of $950 for such taxable year. The basis of the land to A as determined under subparagraph (1) of this paragraph is reduced by $2,850. If on June 1, 1960, A ceases

to rent the building and demolishes it, the balance of the undepreciated portion allocated to the buildings, $950, may be deducted from gross income under section 165.

(3) The basis of any building acquired in replacement of the old buildings shall not include any part of the basis of the property originally purchased even though such part was, at the time of purchase, allocated to the buildings to be demolished for purposes of determining allowable depreciation for the period before demolition.

(b) *Intent to demolish formed subsequent to time of acquisition.*

(1) Except as provided in subparagraph (2) of this paragraph, the loss incurred in a trade or business or in a transaction entered into for profit and arising from a demolition of old buildings shall be allowed as a deduction under section 165(a) if the demolition occurs as a result of a plan formed subsequent to the acquisition of the buildings demolished. The amount of the loss shall be the adjusted basis of the buildings demolished increased by the net cost of demolition or decreased by the net proceeds from demolition. See paragraph (c) of §1.165-1 relating to amount deductible under section 165. The basis of any building acquired in replacement of old buildings shall not include any part of the basis of the property so demolished.

(2) If a lessor or lessee of real property demolishes the buildings situated thereon pursuant to the requirements of a lease or the

requirements of an agreement which resulted in a lease, no deduction shall be allowed to the lessor under section 165(a) on account of the demolition of the old buildings. However, the adjusted basis of the demolished buildings, increased by the net cost of demolition or decreased by the net proceeds from demolition, shall be considered as a part of the cost of the lease to be amortized over the term thereof.

* * *

Reg. §1.167(a)-8. RETIREMENTS –

(a) *Gains and Losses on Retirements*

For the purpose of this section the term "retirement" means the permanent withdrawal of depreciable property from use in the trade or business or in the production of income. The withdrawal may be made in one of several ways. For example, the withdrawal may be made by selling or exchanging the asset, or by actual abandonment. In addition, the asset may be withdrawn from such productive use without disposition as, for example, by being placed in a supplies or scrap account. The tax consequences of a retirement depend upon the form of the transaction, the reason therefor, the timing of the retirement, the estimated useful life used in computing depreciation and whether the asset is accounted for in a separate or multiple asset account. Upon the retirement of assets, the rules in this section apply in determining whether gain or loss will be recognized,

the amount of such gain or loss, and the basis for determining gain or loss:

* * *

(3) Where an asset is permanently retired from use in the trade or business or in the production of income but is not disposed of by the taxpayer or physically abandoned (as, for example, when the asset is transferred to a supplies or scrap account) gain will not be recognized. In such a case loss will be recognized measured by the excess of the adjusted basis of the asset at the time of retirement over the estimated salvage value or over the fair market value at the time of such retirement if greater, but only if —

(i) The retirement is an abnormal retirement, or

(ii) The retirement is a normal retirement a single asset account (but see paragraph (d) of this section for special rule for item accounts), or

(iii) The retirement is a normal retirement from a multiple asset account in which the depreciation rate was based on the maximum expected life of the longest lived asset contained in the account.

* * *

(b) *Definition of normal and abnormal requirements.*

For the purpose of this section the determination of whether a retirement is normal or abnormal shall be made in the light of all the facts and circumstances. In general, a retire-

ment shall be considered a normal retirement unless the taxpayer can show that the withdrawal of the asset was due to a cause not contemplated in setting the applicable depreciation rate. For example, a retirement is considered normal if made within the range of years taken into consideration in fixing the depreciation rate and if the asset has reached a condition at which, in the normal course of events, the taxpayer customarily retires similar assets from use in his business. On the other hand, a retirement may be abnormal if the asset is withdrawn at an earlier time or under other circumstances as, for example, when the asset has been damaged by casualty or has lost its usefulness suddenly as the result of extraordinary obsolescence.

* * *

APPENDIX B

Table of Exhibits Pursuant to Rule 18(2)(b) as amended:

Exhibit	*Identified*	*Offered*	*Received*
1	18	18	18
2	21	21	22
A	61	61	62

No. 18,908

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MEYER FELDMAN,

Appellant,

vs.

WILSON B. WOOD, District Director of Internal Revenue for Arizona,

Appellee.

On Appeal from the Judgment of the United States District Court for the District of Arizona

BRIEF OF APPELLEE

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No. 18,908

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEYER FELDMAN,
Appellant

vs.

WILSON B. WOOD, District Director of Internal Revenue for Arizona,
Appellee.

On Appeal from the Judgment of the United States District Court for the District of Arizona

BRIEF OF APPELLEE

OPINION BELOW

The Court below wrote no oinion. The findings of fact and conclusions of law of the District Court (R. 14-18)[1] are not officially reported.

[1] "R." references are to Volume I of the record on appeal.

JURISDICTION

This appeal involves federal income taxes and interest in the amount of $29,558.32 for the taxable year 1957. Taxpayer paid such tax and interest on August 5, 1961, and on August 11, 1961, filed a claim for refund with the District Director of Internal Revenue for Arizona (R. 1, 6), and on February 28, 1962, such claim was disallowed (R. 2, 6). Within the time provided by Section 6532 of the Internal Revenue Code of 1954, taxpayer brought this action in the District Court for the Distrcit of Arizona. (R. 1-5, 8.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1340. The udgment of the District Court was entered on April 11, 1963 (R. 19), and on June 10, 1963, taxpayer filed a timely notice of appeal (R. 21). Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTION PRESENTED

Whether taxpayer, whose lessee demolished improvements situated on the leased property, is entitled to deduct for the year of demolition his entire unrecovered cost basis for the improvements or whether he is required to amortize his unrecovered cost basis for the demolished improvements over the remaining term of the lease.

STATUTES INVOLVED

Internal Revenue Code of 1954:

SEC. 165. LOSSES.

(a) *General Rule.*—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

* * *

(26 U.S.C. 1958 ed., Sec. 165.)

SEC. 167. DEPRECIATION.

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * *

(26 U.S.C. 1958 ed., Sec. 167.)

STATEMENT

The facts as stipulated by the parties (R. 8-13), adduced by the testimony (Tr. 1-63)[2] and exhibits[3], and as found by the District Court (R. 14-18) may be summarized as follows:

During 1950 taxpayer and his then living wife purchased improved real property in Tucson, Arizona. At the time of acquisition there was situated on the property a residential court and warehouse. (R. 8, 14.) On June 8, 1951, taxpayer entered into a five-year lease (hereinafter called the Blakely lease) of the property excluding the warehouse with M. V. and Geneva R. Blakely. Taxpayer removed the residential court in 1951 and erected a service station building, together with gas pumps, on that portion of the property adjacent to the warehouse. (R. 8, 14-15.)

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[2]"Tr." references are to the transcript of proceedings contained in Volume II of the record on appeal.

[3]On August 27, 1963, the parties stipulated pursuant to Rule 10 of the Rules of the United States Court of Appeals for the Ninth Circuit that the exhibits attached to the stipulations and introduced at trial may be referred to by the parties and considered by the Court without their being included in the printed record.

Taxpayer's wife died on July 2, 1953. The value of the property as of that date was $100,000 apportioned at $55,000 for buildings and $45,000 for land. (R. 9, 15.)[4]

On April 7, 1955, taxpayer entered into a preliminary lease of all the subject property, including the service station building and the warehouse, with Lawrence D. and Pauline Mayer, hereinafter referred to as lessees. This preliminary agreement was incorporated into a final lease agreement (hereinafter called the Mayer lease) on June 1, 1955, which was to run for 99 years from June 1, 1955. (R. 9, 15; Exs. B and C.) On April 15, 1955, taxpayer and the Blakelys amended their lease agreement of June 8, 1951, which had over a year to run on the original term plus an additional five-year option term, to provide that taxpayer could terminate the prior lease on 60 days written notice. (R. 12; Ex. R.)

The Mayer lease included the following provision (R. 15-161; Ex. C) which was inserted at the lessees' request (Tr. 30):

> 11. Lessee shall have the right to remove and demolish any or all existing improvements on the demised premises for the purpose of creating additional parking area, adding improvements, or providing ingress and egress to and from Toole Avenue, any such demolition and/or new improvement to be entirely at the expense of Lessee,***.

The Mayer lease agreement further provided for the assignment to the lessees of all taxpayer's rights under the Blakely lease. The lessees were given an option to purchase the leased property at a price of $160,000 at any time during the first five years of the lease. (Ex. C.)

---

[4]Seciton 1014(a) and (b) (6) gave taxpayer a new basis for the property equal to its fair market value on the date of his wife's death.

In 1960 lessees exercised their option to purchase the property at $160,000. On June 30, 1960, the lease was terminated and a Bargain and Sale Deed was executed. (Deft. Ex. A; see Tr. 61-62.)

In 1957, the year of demolition, the demolished buildings had a remaining useful life of 20-25 years (Tr. 33, 37), and they had an unrecovered cost basis in the amount of $47,300[5] (R. 9, 16-17). In his 1957 income tax return taxpayer included the full unrecovered cost basis—$47,300—in his "Schedule of Depreciation" as a "Building Torn Down—and Abandoned." (R. 8, 16; Ex. A.)[6] The Commissioner disallowed the deduction in the full amount of the unrecovered cost basis but allowed taxpayer an amortization deduction in 1957 in the amount of $485.13, computed by dividing taxpayer's remaining basis in the demolished buildings, $47,300, by 97½, the number of years remaining under the lease at the time of demolition. (R. 16-17) Accordingly the Commissioner assessed an income tax deficiency for 1957 in the amount of $29,558.32 ($24,696.93 tax plus $4,861.39 interest). This action was commenced after taxpayer filed a claim for refund and the claim had been subsequently disallowed. (R. 1-2, 6, 17.)

SUMMARY OF ARGUMENT

A lessor does not incur an economic loss when a lessee demolishes improvements situated upon the leased property. This is because the lessor's rights under the lease are in no

---

[5]Taxpayer's deduction on his 1957 income tax return stated an unrecovered cost basis in the amount of $48,000. This amount was subsequently adjusted to take into account $1,100 of allowable but unclaimed depreciation. (R. 9, 17.)

[6]When in 1960 lessees exercised their option to purchase, taxpayer, in reporting his gain on sale in his federal income tax return, included the $47,300 in basis at that time. (Deft. Ex. A.)

way affected by the demolition. He continues to receive the exact same rentals. Therefore the lessor is not entitled to a deduction under Section 165(a) which requires that a loss actually be sustained. The lessor's unrecovered cost basis in the demolished improvements is considered to be a cost of acquiring a new asset—a lease, whose term exceeds the remaining useful life of the buildings situated on the property when the lease was entered into. Therefore, the unrecovered cost basis must be amortized over the remaining useful life of the lease.

The demolition does not constitute the "abandonment" of "an asset" by "abnormal retirement" within the meaning of Treasury Regulations on Income Tax (1954 Code), Section 1.167(a)-8(a); therefore the lessor is not entitled to a depreciation deduction. Rather the long-term lease is considered to have been received by the lessor in exchange for his having given up the right to the use of the buildings, which were demolished.

ARGUMENT

WHERE TAXPAYER'S LESSEE DEMOLISHED IMPROVEMENTS SITUATED ON THE LEASED PROPERTY, TAXPAYR'S UNRECOVERED COST BASIS IN THE IMPROVEMENTS IS TREATED AS A COST OF ACQUIRING THE LEASE; THEREFORE, TAXPAYER MUST AMORTIZE HIS UNRECOVERED COST BASIS OVER THE REMAINING TERM OF THE LEASE.

A. *Introduction.*

The essential facts in this case are undisputed. On June 1, 1955, taxpayer, as lessor, entered into a 99-year lease (Mayer lease). Under the terms of the Mayer lease the lessee was given the right to demolish then existing improvements. At the time the Mayer lease was entered into a tenant was in possession of

the premises by reason of a prior lease terminable by the will of the new lessee, who was, by the terms of the Mayer lease, entitled to the rental income from the old tenant. (R. 9, 12, 15; Exs. C, Q, R.) The record does not show when the old tenant vacated the premises, but in August 1957 the lessee demolished the old buildings, consisting of a service station building together with gas pumps and a warehouse. (R. 9, 12, 16.) The essential issue to be decided by this Court is whether taxpayer sustained a loss by reason of the lessee's demolition or whether the $47,300 unrecovered cost basis of the demolished buildings was in fact taxpayer's cost of acquiring a new asset — the Mayer lease — and therefore the $47,300 cost of the Mayer lease should be amortized over the remaining 97½-year term of the lease. (R. 16-17.)

B. *Taxpayer did not incur a deductible loss*

The narrow question under Section 165 of the Internal Revenue Code of 1954 is whether taxpayer sustained a loss. No loss was sustained in this case since taxpayer's economic position remained unchanged after the demolition. Taxpayer entered into a valuable lease June 1, 1955. Demolition of the old buildings on the leased premises, a service station building and a warehouse, occurred in August, 1957, at no expense to the taxpayer. The substance of the lease transaction ni this case was that taxpayer's reversionary interest under the Blakely lease in the service station building and his fee ownership in the warehouse was converted into a reversionary interest in both buildings, subject to the 99-year Mayer lease. See *Commissioner* v. *Moore,* 207 F. 2d 265, 272 (C.A. 9th); *Schubert* v. *Commissioner,* 286 F. 2d 573 (C. A. 4th); *Goelet* v. *United States,* 161 F. Supp. 305 (S.D. N.Y.), affirmed *per curiam,* 266 F. 2d 881 (C. A. 2d). Since the taxpayer had acquired a continuing right to rentals for 99 years he could not

realize a loss as a consequence of demolition until the lease either expired or was prematurely terminated. The exercise of lessee's right to demolish the buildings did not produce an economic loss for the taxpayer since the taxpayer's economic position did not change thereby. The monthly rental did not change. The price at which the lessee's option to purchase could be exercised remained the sam.e The rights and obligations of both parties to the lease continued as if the building had not been demolished. See *Blumenfeld Enterprises, Inc.* v. *Commissioner,* 23 T.C. 665, affirmed *per curiam,* 232 F. 2d 396 (C. A. 9th), where the court said (23 T.C., p. 671):

> The term o fthe lease extended substantially beyond the remaining useful life of the building, and since the lessee's obligations under the lease were in no way curtailed upon removal of the building, we cannot conclude that petitioner in fact *sustained any loss* by reason of the demolition. (Emphasis supplied.)

Taxpayer was affected economically only when he gave the lessees the right to demolish, and this right was compensated for at the time that the lease was executed as increased rentals or other consideration. It is true that after the demolition the leased premises was without a building, but this fact did not render taxpayer's lease less valuable; rather it tended to make the lease more valuable since the lessees were in the process of putting the leased premises to a greater economic use. *Blumenfeld Enterprises, Inc.* v. *Commissioner, supra.*

Moreover, Treasury Regulations on Income Tax (1954 Code), Section 1.165-1(b), states:

> Sec. 1.165-1 *Losses.*
>
> * * *
>
> (b) *Nature of loss allowable.* To be allowable as a deduction under Section 165(a), a loss must be evidenced by closed and completed transactions, fixed by

identifiable events, and actually sustained during the taxable year. Only a bona fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss.

* * *

(26 C.F.R., Sec. 1.165-1.)

Losses are recognized for tax purposes only when they result from a closed transaction. Here taxpayer's transaction with respect to the improvements upon the leased premises did not close upon demolition. Rather the substance of the transaction was that on June 1, 1955, taxpayer substituted a new asset — a lease — for an old asset — improvements. To allow taxpayer a deduction for his full unrecovered cost basis would distort taxpayer's income from rentals which by terms of the lease was to remain constant *ab initio.* This would be contrary to the rationale behind the annual accounting concept reflected in the statuatory scheme, which provides for annual reductions from taxable income equivalent to the costs of producing the income.

Thus, demolition, as it occurred in this case, was not an isolated act. Since the act of demolition was pursuant to lessee's right to demolish, the act of demolition should be treated as a part of the original lease tranaction. Since taxpayer's consideration received in exchange for giving lessees the right to demolish continued over the 99-year term of the lease, his cost basis in the demolished asset, which was demolished because of the lease, became a cost of receiving rentals.

The cases have adopted this interpretation. *Young* v. *Commissioner,* 59 F. 2d 691 (C. A. 9th), certiorari denied, 287 U.S. 652, treated the lessees' demolition as lessor's capital expenditure incurred in obtaining an amortizable asset. In *Young* this Court relied upon *Anahama Realty Corp.* v. *Commissioner,* 42 F. 2d 128 (C. A. 2d), certiorari denied, 282 U.S. 854,

where the court said (p. 130), "The removal of the buildings was a part of the cost of acquiring the lease, * * *", and in *Smith Real Estate Co.* v. *Page,* 67 F. 2d 462 (C. A. 1st), the court said (p. 463), "* * * it would seem just and reasonable that the value of buildings removed be charged as a contribution to the cost of securing his lease, * * *". See also *Blumenfeld Enterprises, Inc.* v. *Commissioner, supra; Spinks Realty Co.* v. *Burnet,* 62 F. 2d 860 (C.A. DC.), certiorari denied, 290 U.S. 636; *Nickoll's Estate* v. *Commissioner,* 282 F. 2d 895 (C.A. 7th), affirming 32 T.C. 1346. These cases, relying on substance rather than form, viewed the lessee's right to demolish the building as part of the consideration for the rent due under the lease. Thus a landowner's use of a building was said to have been converted into a right to receive rentals. One of the costs to the lessor in obtaining the lease is his unrecovered cost basis in the building. But since the execution of the lease does not interrupt the landowner's continuing interest in the property the landowner's unrecovered cost basis is not currently deductible, but must be capitalized over the remaining term of the lease. *Young* v. *Commissioner, supra; Blumenfeld Enterprises, Inc.* v. *Commissioner, supra; Anahama Realty Corp.* v. *Commissioner, supra; Smith Real Estate Co.* v. *Page, supra; Spinks Realty Co.* v. *Burnet, supra; Nickoll's Estate* v. *Commissioner, supra.*

Thus it is clear under the statute and the cases that a lessor does not incur a loss when a lessee demolishes buildings situated on leased premises.

Taxpayer's entire argument in support of his claimed loss deduction is couched within the meaning he imparts to Treasury Regulations Section 1.165-3 (b) (2) and particularly the word "requirements." Taxpayer interprets the word "requirements" altogether too narrowly in the context of the

regulation and the relevant case law.[7] The Regulations did not intend to restrict the denial of a loss deduction to situations where under the mere literal terms of the lease the lessee was obligated to demolish. In the first place the substitution of the word "requirements" for the word "terms", which appeared in the Proposed Regulations, broadened rather than narrowed the regulations. Demolition pursuant to the "terms" of a lease means literally that the lease must explicitly contemplate demolition. Since what a lease requires commonly refers to the lawful economic use of the premises, demolition pursuant to the "requirements" of a lease means that the lease must implictly contemplate demolition in order to put the premises to lawful economic use. Since under the facts and circumstances of this case, the lessee deemed the construction of a parking garage an efficient economic use of the premises and since such construction required the demolition of pre-existing improvements, taxpayer fits squarely within the regulations which denies him a loss deduction.

The second reason why taxpayer's interpretation of the word "requirements" is too narrow is that the relevant case law does not support the distinction he draws between the lessee's right to demolish and his legal obligation to demolish. It is assumed that the Commissioner intended the regulation to be interpretative of and therefore consistent with the relevant case

[7]Taxpayer relies upon correspondence between taxpayer's accountant and the Commissioner of Internal Revenue prior to the Commissioner's adoption of his final Regulations, the inadmissability into evidence of which was objected to by the Government on the grounds of incompetency and irrelevancy. Since taxpayer has not shown that this one letter written on behalf of a single taxpayer convinced the Commissioner to adopt a particular wording of the regulation for the reasons urged by taxpayer's representative, the supposition should not be drawn that a particular wording of the regulation was adopted for the *reasons* given by that one interested taxpayer representative.

law rather than to narrow the application of the case law, which would be the effect of taxpayer's interpretation.

It is clear that the cases do not distinguish between the lessee's right to demolish and his legal obligation to demolish. For example, the *Blumenfeld Enterprises, Inc.* lease, contrary to taxpayer's assertion, did not require demolition. There the lease agreement entered into October 6, 1949, contemplated that the lessee would remodel, not demolish, existing buildings. A letter agreement entered into April 24, 1950, permitted (as opposed to required) the lessee to demolish the existing buildings. The Tax Court said (23 T.C., pp. 671-672):

> To be sure, the demolition of the theatre building was not contemplated at the time of execution of the agreement of October 6, 1949, but, prior to the commencement of the lease (May 1, 1950), it had become abundantly clear that the entire purpose of the lease would be defeated unless the building were demolished. And it was in recognition of this plain fact that the *permission* to remove the building was granted on April 24, 1950. The provision granting that *permission* was a modification of the original agreement, and the lease must be regarded as founded on both the October 6, 1949 and April 24, 1950, agreements. Indeed, the razing of the building may well have constituted a benefit rather than a detriment to petitioner. The evidence suggests that the building was obsolete or obsolescent, and the rather substantial cost of demolition was borne by the lessee. Here then was a situation where such a building was removed at the expense of the lessee who was about to begin a long-term lease under terms and conditions that appear to have been highly favorable to the lessor. From the lessor's point of view the building was being replaced by an advantageous lease and therefore no deductible loss is allowable in accordance with the holdings in the

> cited cases that the unrecovered cost of the razed building is to be treated as part of the cost of the lease. (Emphasis added.)

In *Blumenfeld Enterprises, Inc.,* neither the April 24, 1950, agreement which gave the lessee the right to demolish nor the act of demolition itself affected the rentals received by taxpayer-lessor under the original lease agreement. In this case, as taxpayer stated in his brief (p. 17), "While demolition was permitted in the Mayer lease, there is no showing that it [the act of demolition] was part of the consideration or affected the rental rate". Thus, *Blumenfeld Enterprises, Inc.* is very similar to this case. In both cases the lessor's consideration received under the lease (rentals and other rights) was not affected at all by the lessee's decision to demolish or by the act of demolition. The reason for the denial of a loss deduction in each case was because lessee's right to demolish existing buildings was reflected under the lease as additional consideration to the lessor.

Furthermore in *Nickoll's Estate* v. *Commissioner, supra,* where the "* * * lease *permitted* * * * [the lessee] to make necessary alterations and additions to the building suitable to its commercial needs" (emphasis supplied) (282 F. 2d, p. 896),[8] the court did not find that the lessee was obligated to demolish in order to make additions or improvements. Thus, the court did not interpret the wording of the lease to obligate the lessee to demolish existing improvements. Rather the court said (282 F. 2d, p. 897):

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[8]The Tax Court and Court of Appeals said, "Specifically, the 30-year lease agreement between taxpayers and * * * [lessee] provided that the tenant would make replacements, repairs, additions, improvements, alterations or changes necessary for its business * * *." *Nickoll's Estate* v. *Commissioner,* 282 F. 895, 896, affirming 32 T.C. 1346, 1347.

> The old building was substantially demolished as a necessary condition precedent to the execution of a remunerative lease under which taxpayers became the owner of a remodeled building. The value of the old building which was partially demolished is properly charged as a cost of acquiring valuable lease rights and is to be amortized over the life of the lease.

Nickoll's Estate was decided after the enactment of Regulations Section 1.165-3(b)(2), and the court, citing *Young,* denied the lessor a loss deduction for his unrecovered cost basis in the demolished improvements. The court's opinion quoted the regulation and stated, "Our position is consistent with a recently promulgated Treasure Regulation." (282 F. 2d, p. 897.)

C. *The taxpayer is not entitled to a depreciation deduction since the demolition of the buildings did not constitute the "abandonment" of "an asset" by "abnormal retirement"*

Taxpayer invokes Regulations Section 1.167(a)-8(a)(3) as the second of his two-pronged attack. Regulations Section 1.167(a)-8(a)(3) provides for the "recognition" of loss when a depreciable asset is "abandoned" by "abnormal retirement". The difficulty with taxpayer's argument is indicated by the wording of the subject title to Regulations, Section 1.167(a)-8(a), *Gains and losses on retirements.* Though the section provides that certain losses are recognized, it says nothing about whether a loss is allowed. Therefore it is necessary to determine whether taxpayer incurred a loss as a result of the demolition. The cases all show that demolition losses are not allowable in the year of demolition and that taxpayer's unrecovered cost basis must be amortized over the remaining term of the lease. *Young* v. *Commissioner, supra; Spinks Realty Co.* v. *Burnet, supra; Blumenfeld Enterprises, Inc.* v. *Commissioner, supra; Anahama Realty Corp.* v. *Commissioner, supra; Smith Real Es-*

tate Co. v. *Page, supra; Nickoll's Estate* v. *Commissioner, supra.* See also *Rowan* v. *Commissioner,* 22 T.C. 865, and *Schubert* v. *Commissioner,* 286 F. 2d 573 (C. A. 2d), where taxpayers properly amortized unrecovered basis over the term of the lease.

The further difficulty with taxpayer's reliance upon Regulations Section 1.167(a)-8(a)(3) is that the transaction which occurred in this case does not *in substance* constitute the "abandonment" of "an asset" by "abnormal retirement". The demolition is not a closed transaction. Rather, as the cases show, the *substance* of the transaction is that taxpayer received a valuable asset, a 99-year lease entitling him to rentals and a reversion in the buildings in exchange for relinquishing the fee ownership in the buildings. Were taxpayer to have merely demolished the buildings and not received a valuable lease by reason of such demolition, he would have been entitled to deduct his full unrecovered cost basis of the demolished buildings in the year of demolition. However, here the demolition must be viewed in the light of the surrounding circumstances, which were that taxpayer acquired a valuable lease over whose term the cost of obtaining the lease should be amortized.

It is clear that as a prerequisite to a depreciation deduction the taxpayer must own a present interest in a wasting asset. *Weiss* v. *Wiener,* 279 U.S. 333; *Helvering* v. *Lazarus & Co.,* 308 U.S. 252. As stated in *Lindheimer* v. *Illinois Tel Co.,* 292 U.S. 151, 167:

> Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence. Annual depreciation is the loss which takes place in a year.

Or as the court said in *Schubert* v. *Commissioner, supra,* 286 F. 2d, p. 579:

> * * * before any deduction for depreciation can be allowed, the taxpayer must first establish that she has an *interest in "'property"* with respect to which the allowance for depreciation is authorized by the statute. (Emphasis supplied.)

Since taxpayer had acquired a lease whose term exceeded the useful life of the building thereon, taxpayer was in no way economically affected by the demolition of the building. In *Commissioner* v. *Moore, supra,* the Court said (p. 268):

> It is not the physical property itself, nor the title thereto, which alone entitles the owner to claim depreciation. The statuatory allowance is available to him whose interest in the wasting asset is such that he would suffer an economic loss resulting from the deterioration and physical exhaustion as it takes place.

See also *Commissonier* v. *Pearson,* 188 F. 2d 72 (C. A. 5th). Taxpayer did not suffer an economic loss by reason of the demolition of the building; rather any economic loss resulted from the gradual reduction of the remaining term of the lease, and as a consequence of this loss he is entitled to amortize his unrecovered basis for the demolished building during each year of the lease.

This case is analogous to the situation where under the terms of a long-term lease the lessee undertakes to make good the physical exhaustion as it takes place. In these circumstances the lessors, notwithstanding an original capital investment and the possession of a cost basis, suffers no economic loss due to the wear and tear or decay of the property upon the leased premises and therefore is not entitled to depreciation. *Georgia Ry. & Electric Co.* v. *Commissioner,* 77 F. 2d 897 (C. A. 5th), certiorari denied, 296 U.S. 601; *Commissioner* v. *Terre Haute Elec. Co.,* 67 F. 2d 697 (C. A. 7th), certiorari denied, 292 U.S. 624. See also, Rev. Rul. 62-8, 1962-1 Cum. Bull. 31.

Taxpayer in his brief cites three cases for the proposition that demolition constitutes the type of redetermination of use-

ful life entitling him to a depreciation deduction of the full amount of unrecovered cost basis of the demolished asset. Close reading of these cases will show that none of them support this proposition. In *Cosmopolitan Corp.* v. *Commissioner,* decided June 12, 1959 (P-H Memo T.C., par. 59, 122) (Br. 20), a lessor and its successor sought to deduct as depreciation the full unrecovered cost basis for buildings which had been demolished in order to make the property available to a lessee. The Tax Court was compelled to allow the taxpayers a depreciation deduction for the full amount of their unrecovered cost basis in the demolished building because the Commissioner had conecded this issue on brief. Even so, the Tax Court said "It is difficult to see that the preparatory steps (demolition) taken principally in the latter part of 1952 could successfully enable them to recover their entire basis in that year or the succeeding one when a few months' difference would eliminate such immediate recovery entirely." In making this statement, the court relied upon *Estate of Appleby* v. *Commissioner,* 41 B.T.A. 18, affirmed, 123 F. 2d 700 (C.A. 2d); *Berger* v. *Commissioner,* 7 T.C. 1339; *Blumenfeld Enterprises Inc.* v. *Commissioner, supra,* in concluding that if demolition had occurred in 1953 taxpayer would have been required to amortize his unrecovered cost basis rather than to deduct the full amount immediately. Thus, if the Commissioner had not conceded the depreciation issue, it is clear that the court would have denied depreciation in one taxable year and would have required amortization of the full unrecovered cost basis over the term of the lease which taxpayer subsequently entered into.

Klinck v. *Commissioner,* decided December 3, 1952 (P-H Memo T.C., par. 53,007) (Br. 20), held that depreciation deductions were excessive during two taxable years since taxpayer had received an appraisal report prepared early in the first of the two taxable years showing that the assets' useful life had

been underestimated. There was no mention of demolition in that case. *Cohn* v. *United States,* 259 F. 2d 371 (C. A. 6th) (Br. 21), involved the question whether depreciation is allowable in the year of disposition of an asset if the salvage value of the asset exceeds its adjusted basis at the beginning of the year of disposition. There was no question of demolition in that case.

CONCLUSION

The appellee respectfully submits that the decision of the District Court was correct and should be affirmed.

Respectfully submitted,

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April, 1964

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

Dated: .... day of April, 1964.

____

Assistant United States Attorney

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MEYER FELDMAN,
Appellant,

vs.

WILSON B. WOOD,
District Director of Internal Revenue for Arizona,
Appellee.

No. 18,908

On Appeal From the Judgment of the United States District Court for the District of Arizona

REPLY BRIEF FOR THE APPELLANT

FILED

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I. THE SECTION 165 LOSS ISSUE.

The Government bases its argument that taxpayer did not suffer a deductible loss on the contention that he suffered no "economic loss" since, it is claimed, his "economic position" did not change (B.8). The Internal Revenue Code does not define the term "loss". The Regulations do. The Government's position assumes that it is necessary to have an economic loss in order to have a deductible loss. There are a number of situations under the Internal Revenue Code as interpreted by the Regulations where the loss allowed does not conform to the common and usual understanding of the term "loss".

For example, in the area of business casualty losses, under this very Code section, Treasury Regulations 1.165-7(b) provide that if property used in a trade or business is totally destroyed by casualty, and if the fair market value of such property immediately before the casualty is less than the adjusted basis of such property, the adjusted basis shall be treated as the amount of the loss for purposes of Section 165. Other examples occur in the area of exchanges where a taxpayer may have an "economic loss" from the exchange of a piece of property, but not be able to take such loss for tax purposes until the property received in exchange is sold in a later year. (Internal Revenue Code 1954, Section 1031 et. seq.)

Thus, the Regulations evidence a quite clear plan and intent that business losses shall be treated in a fashion different from non-business losses. Whether due to abnormal retirement, to a casualty (such as fire), to demolition, or to any other cause (such as theft), the Regulations provide that the amount of the deduction shall be the tax basis of the property, even if the tax basis exceeds the fair market value thereof; (see, for instance. Reg. 1.165-8(c)), which relates to theft losses and provides: "The amount deductible under this section in respect of a theft loss shall be determined consistently with the manner prescribed in Reg. 1.165-7 for determining the amount of casualty loss allowable as a deduction under Section 165(a)." As previously cited, Reg. 1.165-7(b) proceeds to set up as a general rule that the amount of the loss shall be no greater than the difference between the fair market value of the property immediately prior to the event and its fair market value immediately thereafter. If this were all that the Regulation provided, the Government's argument would be supported thereby. However, the

Regulation then goes on to state an exception to this general rule of economic loss, in these words: "However, if property used in a trade or business or held for the production of income is totally dstroyed by casualty, and if the fair market value of such property immediately before the casualty is less than the adjusted basis of such property, the amount of the adjusted basis of such property shall be treated as the amount of the loss for purposes of Section 165(a)." It should seem obvious from this that the plan of tax law is not, as the Government contends, to allow only an economic loss sustained in the specific tax year in which the event takes place, but is rather tied to the basic philosophy of allowing the taxpayer to recover his tax basis in business property.

Thus, the rule of Treasury Regulation 1.165-3(b), (Appendix, Opening Brief) is part of a consistent pattern, which allowed to this taxpayer, depreciation on the buildings while they stood, and allows him to deduct their unrecovered cost when they are demolished. The cited Regulation provides: "The amount of the loss shall be the adjusted basis of the buildings demolished, increased by the net cost of demolition or decreased by the net proceeds from demolition." This rule applies, under the clear plan and wording of the Regulation, to all situations where "Intent to demolish [was] formed subsequent to time of acquisition," with the one exception of the situation where the demolition takes place as a quid-pro-quo for obtaining a lease.

An entirely different rule applies to property that is neither used in a trade or business, nor held for the production of income. Since no depreciation is allowable on such property, the maximum loss deductible for any purpose on such property is the decline in fair market value. As to such property, the Government's argument of economic loss would be valid. It is simply

inappropriate here, since we are dealing with business property, rather than non-business property.

Assuming, however, for purposes of argument, that the Government is correct in stating that there must be some sort of "economic loss", they are not correct in concluding that there was no economic loss to this taxpayer by reason of the lease and subsequent demolition. Its contention, (B.8), that the Mayer lease was more valuable, is without a factual basis for the following reasons:

(1) The Blakely lease (Ex.Q.) was for a five-year term, while the Mayer lease (Ex.C.) was for a 99-year term. Thus, the Blakely lease allows the lessor to realize appreciation in the value of the property, while in the Mayer lease the lessee would realize most of the benefit. The Mayer lease would permit the value of the lessor's interest to increase only by reason of re-evaluation of the rental at every ten-year period. The rental increase is 12½% each ten years, or 1¼% annually, which is far below predicted and actual appreciation. Thus, under the Blakely lease, which would have expired in 1956, or in 1961 if Blakely had exercised his renewal option, taxpayer would have received the benefit from appreciation of the property, while under the Mayer lease, the lessee receives the benefit of the appreciation. Contrary to the Government's contention that the demolition would make the lease more valuable, "since lessees were in the process of putting the leased premises to a greater economic use," (B.8), the Mayer lease provides (Par.15), that any readjustment of rent shall be on land value only, not improvements. From this we may conclude that the taxpayer will receive no compensation for any improvements made under the Mayer lease. If we then consider that this is a 99-year lease, and a lessee constructed build-

ing, having a real life of 40-50 years, and a useful life of 20-25 years, (R.II. 33), the taxpayer's interest in this building is zero. *Mary Young Moore* v. *Commissioner*, 207 F.2d 265 at 271 (C.A. 9th).

2. The Blakely lease provides that the lessee cannot sublet and that no assignment of the lease could be made by lessee without prior consent of lessor, (Ex. A., p.3). The Mayer lease provides for unrestricted assignability and subletting by the lessee, (Ex.C., p.14).

3. The Blakely lease provides that the lessee shall be personally liable to the lessor, and that this liability shall continue regardless of any assignment made by the lessee, (Ex.Q., p.3). The Mayer lease provides for unrestricted assignment, and further provides that after such assignment the lessee shall no longer be personally liable, providing only that improvements of $75,000.00 are made at some time during the 99-year term, (Ex.C., p.14).

4. The Blakely lease provides that the premises should be used for a service station, parking lot and automobile business, (Ex.Q., p.3). The Mayer lease contains no restrictions as to use. Under the Mayer lease, the lessee is free to use the property for any purpose whatsoever, and the lessor could not prevent an uneconomic use which might result in insolvency of his lessee and devaluation or loss of his property interest.

5. The Blakely lease contains no subordination provision. The Mayer lease provides that the lessee may place a mortgage on the leased premises for the purpose of raising funds with which to construct improvements, and provides further that lessor is obligated to join in the execution of the note and mortgage (without personal liability), and is obligated to subordinate the own-

ership of the land to the lien of the mortgage, (Ex.Q., p.9). The taxpayer thus stood in danger of losing his entire equity in the property.

6. The Blakely lease contains no eminent domain provision, while the Mayer lease provides for termination of the lease in the event more than 30% of the property is taken by eminent domain and for abatement of rentals in the event that any part of the property is taken by eminent domain, (Ex.Q., p.9).

The Government bases the major part of its argument on the assumption, wholly unsupported by the evidence, that the lease was a valuable replacement for the demolished buildings. The above provisions refute this assumption, and the subsequent conduct of lessee Mayer proves it completely erroneous. Mayer, after demolition, construction a $400,000.00 building on the premises, (R.I. 12). The building and lease were assigned by Mayer to his "dummy corporation," (R.I. 44), whatever that may be. Taxpayer's interest therein was subordinated to a $555,000.00 lien of a first mortgage, (Ex.K, L, M.). Mortgage funds were expended on an entirely different piece of property in which taxpayer had no interest, (R.II. 50,54). The "dummy corporation" had no assets, and was delinquent in rent, taxes and mortgage principal payments, (R.II 44,46,54). From shortly after the date of the assignment by Mayer to Title Building Construction, (Ex.K,L), in 1956, taxpayer had nothing except the agreement of this "dummy corporation," with no assets, to pay him rent on a piece of land and building which were mortgaged substantially in excess of cost basis.

The net result of the Mayer lease to taxpayer, either before or after demolition, was that he was in a much worse economic position. The Mayer lease, by its very

terms, had a built in potential economic loss, and when all the surrounding facts and circumstances are looked at (as we are cautioned to do in *Young* v. *Commissioner*, 59 F.2d 691 (C.A. 9th), and *Manning* v. *Commissioner*, 7 B.T.A. 286), the demolition and subsequent construction merely accrued that loss.

The Government, (B. 9), states that the act of demolition should be treated as part of the original lease transaction. We do not know why this follows. The uncontroverted evidence shows that no immediate demolition was contemplated. The Government, either through direct evidence or cross examination, did not tie the demolition in 1957 to the 1955 lease, or the earlier 1951 lease. The fact that provision for demolition and for erection of improvements appears in the lease is irrelevant, for the lease term extended greatly beyond the useful life of the buildings and it was apparent to both lessor and lessee that at some time in the future something would have to be done about razing the old improvements and erecting new. The lessee would have been naive if he had not requested such a provision, and the lessor unreasonable if he had withheld it. However, such a provision is far different from one where, as consideration for the lease, the buildings are immediately demolished. Apparently, the Government refuses to concede that there can ever be a lease in which there can be a loss by reason of demolition. In fact the Government so states on page 10 of its brief:

> "Thus it is clear under the statute and cases that a lessor does not incur a loss when lessee demolishes buildings on leased premises."

This cannot be the law. If this is the law, why was any Regulation as to losses on leased property ever promulgated by the Commissioner of Internal Revenue?

If a taxpayer demolishes a building as a condition to entering into a favorable lease, then it is well settled that the unrecovered cost of the building becomes part of the lease. The unrecovered cost of the building then is no different than any other consideration paid to induce a lessee to execute a lease, and the Government has cited many cases to this effect—all of which we do not dispute. However, what of the lease that merely permits demolition; the lease in which demolition occurs several years later; and the lease in which demolition is not negotiated as a part of the rental consideration? Are not these the situations which the Regulation sought to clarify? If the Government believes, as it states, that there are no situations in which a lessor is entitled to a loss deduction for demolition by his lessee, then this Regulation should be repealed. It is not fair to the many accountants and tax advisors throughout the country to assume that this Regulation has some meaning and guidance, when the Government believes it does not. Mr. Justice Holmes said that men must turn square corners when they deal with the Government, and it is assumed that the same applies to the Government's relationship with taxpayers.

This "economic loss" argument becomes especially difficult to understand when we look at the long term economic effect of the Government's position. When this taxpayer dies, his heirs will take this property at its fair market value, but they will not be entitled to any part of the 99 years of amortization remaining at taxpayer's death, nor will they be allowed any depreciation deduction. *Rowan* v. *Commissioner*, 22 T.C. 865; *Mary Young Moore* v. *Commissioner*, 207 F.2d 265 (C.A. 9th). For these capital improvements, a deduction beyond taxpayer's life expectancy has been lost forever, to everyone.

While the Government would apparently like to

ignore this Regulation altogether, it does take the trouble to argue that demolition pursuant to the "requirements" of lease only must imply demolition, but if demolition is pursuant to the "terms" of a lease, it means that the demolition must be clearly expressed, (B.11). This reversal of the common meaning of these words then leads it to the conclusion that demolition pursuant to the "terms" of a lease is much narrower in meaning than demolition pursuant to the "requirements" of a lease. There is no justification for torturing the meaning of these words of common usage.

The general rule for the construction of language used in a statute, (or as here, a Regulation) apply, i.e., words do not acquire a different meaning when used in a statute; ordinarily they are to be given their usual, natural, plain, ordinary and commonly understood meaning. *Crane* v. *Commissioner*, 331 U.S. 1; *Helvering* v. *Hutchings*, 312 U.S. 393. The reason cited for changing the meaning of these commonly used words is that we must do so to make it consistent with relevant case law, (B.11,12). Assuming this is sufficient, and we do not believe it is, we entirely disagree with the Government's conclusion that our interpretation is inconsistent with relevant case law. It cites *Blumenfeld Enterprises, Inc.* v. *Commissioner*, 23 T.C. 665, aff'd per curiam 232 F.2d 396, and *Nickolls Estate* v. *Commissioner*, 282 F.2d 895. We discussed *Blumenfeld* in our opening brief, (B.16-18). The *Nickoll's Estate* case is not factually similar to the instant case. Counsel interprets *Nickoll* as merely authorizing demolition. The Tax Court opinion states: (32 T.C. 1346 at 1348):

> "Respondent [Government] contends that inasmuch as petitioners received a new lease covering a period of 30 years in which the lessee obligated itself to demolish the old building and to construct a new

building on the premises. . . ."

The Seventh Circuit Court opinion states, (282 F.2d 895 at 897):

> "The old building was substantially demolished as a *necessary* condition precedent to the execution of a remunerative lease under which taxpayers became the owner of a remodeled building. . . ." (underscoring supplied).

Under these circumstances, it appears there was no necessity for the Seventh Circuit Court to determine whether the term "requirement" should be construed as the Government now contends.

The Government has not cited one case involving a demolition which took place years after the property was acquired, and years after the lease was entered into, where the loss has been disallowed. In the cases it cites, the demolition was either required by the lease (or a modification thereof entered into prior to the effective date of the lease), or was performed prior to the tenant entering onto the premises. If the lease takes place at the time the property is turned over to the lessee, the act of demolition itself would determine the intent of the parties that the right to demolish was a quid-pro-quo for an advantageous lease. Further, the *obligation* (as in *Nickoll*) that a lessee demolish the old building, and construct a new building when a 30-year lease is involved, is factually far removed from granting *permission* to demolish buildings with estimated lives of under 25 years when a 99-year lease is being entered into.

II. THE SECTION 167 DEPRECIATION QUESTION.

The Government fails to face up to and meet this issue. It states (B.14): "though the section [Section 1.167

(a)-8-(a), *Gains and Losses on Retirements*] provides that certain losses are recognized, it says nothing about whether a loss is allowed. We do not understand what the Government is trying to say. Is it saying that a recognized loss may not be allowed? The Regulations make no such distinction. We are aware of no cases that make such a distinction. A fair reading of the Regulation leads us to believe that a recognized loss means an allowable loss. This statement does serve to let the Government slip into the same argument, (and to cite the same cases), used in connection with its contention that the Section 165 business loss Regulations do not apply to this taxpayer, (B.14,15). It chooses to ignore that Section 167 is a depreciation section, and that the particular Regulation cited deals with the depreciation concept of an abnormal retirement. In our opening brief, (B.20,21), we discussed depreciation and retirement of cases. We do not think that the substance over form argument of the Government explains why this Regulation and these depreciation principles and cases are not applicable to this taxpayer.

The Government makes the following interesting statement, (B.15):

> "Were taxpayer to have merely demolished the buildings and not received a valuable lease by reason of such demolition, he would have been entitled to deduct his full unrecovered cost basis of the demolished buildings in the year of demolition."

Is this not a confession of the correctness of taxpayer's position here? The Government is saying that if there is demolition not in exchange for a lease, the deduction is allowable. The uncontroverted evidence, in the instant case, is that the demolition was not bargained for, and was not in exchange for the lease.

The cited Regulation deals squarely with taxpayer's situation. A taxpayer is entitled to recover his capital investment in building improvements. This benefit is not changed one bit by his leasing the property to someone. While the buildings stand, the depreciation is based upon their estimated life to the taxpayer. *The Hertz Corporation* v. *United States,* 364 U.S. 122. When they are demolished, the unrecovered cost is to be allowed as a deduction in the year of demolition. It is not necessary, and it would be impossible, except in rare instances, for a taxpayer to show an economic loss on the demolition itself, since demolition will only take place if the demolisher believes that the property is better off without the improvements than with them. The Government's argument implies the existence of a rule to the effect that upon entering into a lease for a term longer than the useful life of the buildings, the taxpayer's unrecovered cost of the buildings becomes part of the basis of the lease. By so doing, it has reached a result which is inconsistent with the basic framework of the tax law, is inequitable when applied to this taxpayer, and is contrary to existing case law. *Swoby Corporation* v. *Commissioner,* 9 T.C. 887; *Alaska Realty Co.* v. *Commissioner,* 141 F.2d 675 (C.A. 6th).

The basic framework in regard to depreciation is set forth in Mertens Law of Federal Income Taxation, Vol.4, Sec.23.04, pp.12-13, as follows:

> "In terms of purpose, the allowance under the code of a deduction for depreciation has been judicially stated to permit the taxpayer to recover his capital investment (cases cited) in wasting assets free of income tax. (Cases cited). That statutory method is satisfied by any method of accounting under which the taxpayer can arrive at 'a reasonable allowance' for depreciation."

The Government's refusal to recognize a change in

the law, and a change in its rulings, is no more evident than its statement, (B.16), that the instant case is analogous to the situation, where, under the terms of a long-term lease, the lessee undertakes to make good physical exhaustion as it takes place. It then states that in such a situation the lessor is not entitled to depreciation, *when the exact opposite is true,* and the Revenue Ruling it cites says so.

Revenue Ruling 62-8, 1962-1 Cum.Bull. 31 at 34 states:

> "In view of the foregoing, it is held that a lessor may, upon proper showing, be entitled to some allowance for depreciation (including any obsolescence) of leased depreciable property in a taxable year or years during the term of a lease for several years, even though the lessee has agreed to so preserve, replace, renew and maintain such property, and all additions, amendments, and improvements thereof, that, at the termination of the lease, the property shall be in at least as good condition as at its beginning."

The fact that the claimed depreciation by abnormal retirement, in the instant case, occurred in the space of one taxable year, does not affect the claimed deduction. This Court stated in *Keller Street Development Co.* v. *Commissioner,* with reference to a claimed depreciation deduction for obsolescence, 323 F.2d 166 at 172:

> "* * * It is conceivable that an external force may arise within a single taxable period which will cause the sudden uselessness of a business asset. There is no compelling logic persuading this court to formulate a rule which would permit the allowance of an obsolescence deduction when the process of growing useless occurs over a thirteen month period but which would require the disallowance of such a deduction if the process of growing useless occurs within a twenve-month period. The taxpayer should

> be permitted to recoup the capital expended for the property out of its earnings during the period in which the property grows useless regardless of the length of that time period."

If we accept the Government's basic argument, as stated throughout its brief, (B. 8,11,16), that taxpayer was not economically affected by the demolition since he received a lease whose term exceeded the useful life of the buildings, is not the Government in a completely illogical position? The Government allowed a depreciation deduction for all years including 1957, (R.I. 9,17). If taxpayer ceased to have an economic interest in the building sufficient to justify a depreciation deduction, he ceased to have such an economic interest on June 1, 1955, when the lease for 99 years was executed. If he continued to have an economic interest in the building sufficient to justify depreciation for the last half of 1955, all of 1956 and the first seven months of 1957, he is entitled to recover his entire basis for depreciation in 1957 at the time the building was demolished, either as a demolition loss pursuant to the loss regulations, or as a depreciation deduction, which deduction is making good inadequate prior depreciation, the inadequacy of which was determined by the event of demolition.

CONCLUSION

It is respectfully submitted that for the foregoing reasons, the trial court should be reversed.

Respectfully submitted,

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No. 18910

In the United States Court of Appeals for the Ninth Circuit

LAWRENCE Y. S. AU and WRONA K. H. AU, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decision of the Tax Court of the United States

---

BRIEF FOR THE RESPONDENT

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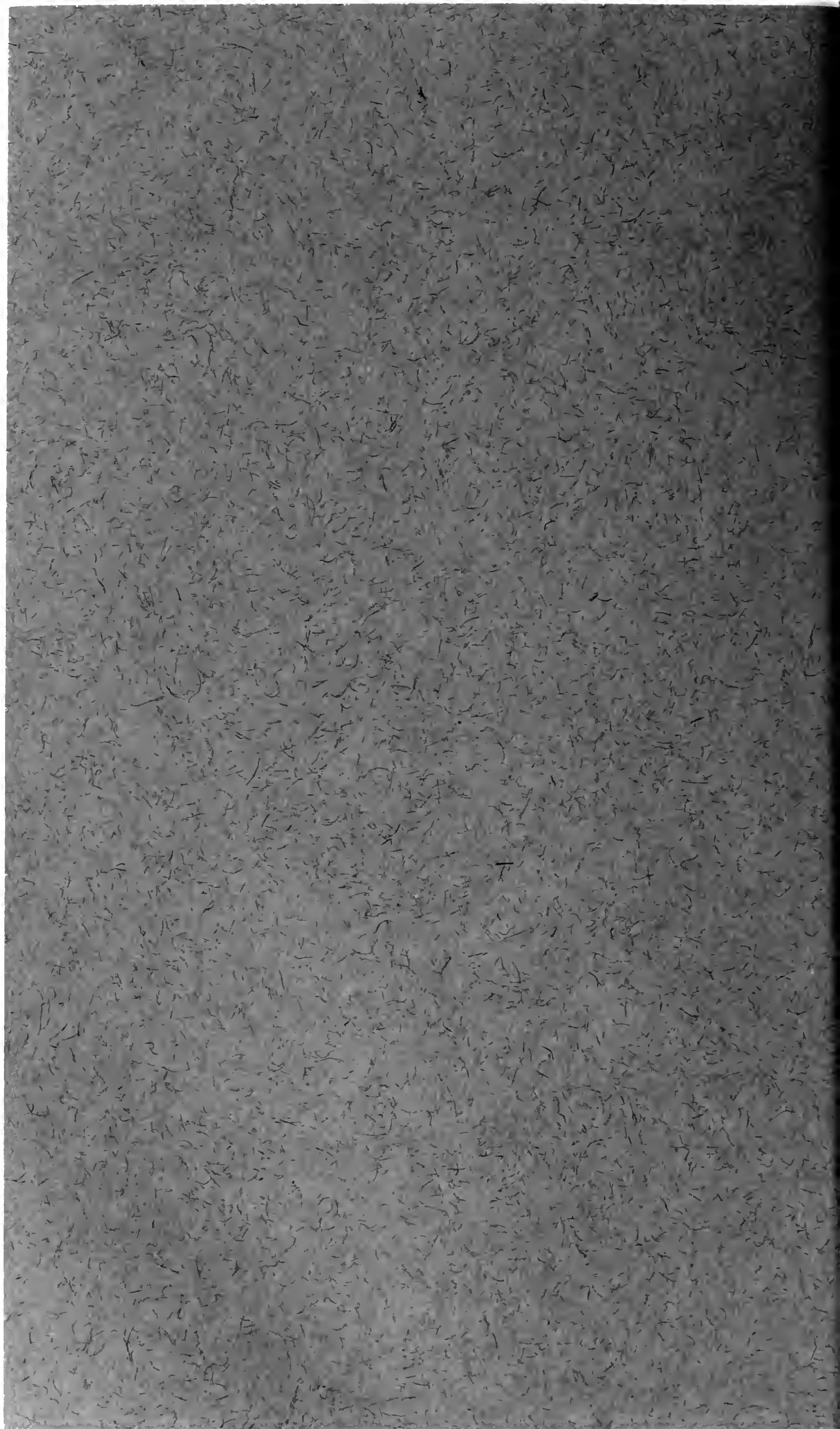

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Tax Court is reported at 40 T.C. 264.

JURISDICTION

This petition for review (R. 52-53) involves federal income taxes for the taxable year 1957. On June 30, 1960, the Commissioner of Internal Revenue mailed to the taxpayer a notice of deficiency, asserting deficiencies in those taxes in the amount of $62.06. (R. 1, 5-6.) Within 90 days thereafter, on

August 29, 1960, the taxpayer filed a petition with the Tax Court for a redetermination of those deficiencies under the provisions of Section 6213 of the Internal Revenue Code of 1954. (R. 1-3.) The decision of the Tax Court was entered on May 10, 1963. (R. 29.) The case is brought to this Court by a petition for review, postmarked August 8, 1963, and filed on August 12, 1963, a Monday. (R. 52-54.) The petition was timely filed under the provisions of Sections 7483, 7502 and 7503 of the Internal Revenue Code of 1954. Jurisdiction in this Court is invoked under Section 7482 of that Code.

QUESTION PRESENTED

Whether the taxpayer's depreciation basis for an automobile acquired and used for six years for personal purposes and then converted to business use is the fair market value of the auto at the time of the conversion, as found by the Tax Court, or the taxpayer's original cost as urged by the taxpayer.

STATUTES AND REGULATIONS INVOLVED

The pertinent parts of the statutes and Regulations involved are set out in the Appendix, *infra.*

STATEMENT

The relevant facts as found by the Tax Court may be stated as follows (R. 18-23):

Taxpayers, husband and wife, are, and were during the year 1957, residents of Honolulu, Hawaii.

They filed a timely joint federal income tax return for the year 1957 with the District Director of Internal Revenue at Honolulu, Hawaii. Taxpayer Wrona had no separate income and is one of the taxpayers solely because a joint return was filed. Hereinafter Lawrence will be referred to as the taxpayer.

During 1957 taxpayer was a salaried employee of Leahi Hospital in Honolulu, where he was employed as its chief accountant. During that year he also worked as a public accountant.

Taxpayer's brother, Alfred Y. K. Au, hereinafter referred to as Alfred, was at all times material hereto a resident of Honolulu, Hawaii. During 1957 Alfred was employed by the City and County of Honolulu as a salaried auditor. He also rendered services to private clients as a certified public accountant.

On his 1957 income tax return, taxpayer reported salary from his employer and also profits from business. On Schedule C, taxpayer listed his principal business activity as a public accountant. He reported gross receipts of $1,756.80, business deductions of $904.20, and a net profit of $852.60. Business deductions claimed were as follows:

Depreciation on 1950 automobile	$500.00
Automobile repair	71.04
Automobile insurance	33.00
Automobile gas	143.78
Taxes on business and business property, and license	31.38
Public relations, dues, and subscriptions	125.00
	$904.20

Taxpayer reported no partnership income on his 1957 income tax return.

The automobile on which depreciation was claimed was a 1950 four-door Plymouth sedan which had been purchased by taxpayer in the early part of 1951 for $2,500. Prior to 1957 taxpayer made no business use of the automobile; in 1957 he converted it to business use. The original cost to him of $2,500 was used by the taxpayer as his basis for depreciation. A straightline method of depreciation and a life of five years were adopted.

In September, 1959, taxpayer was advised by the Commissioner's examining agents that his 1957 joint income tax return was being audited and that a question was being raised as to the proper basis for depreciation of the 1950 automobile.

On May 12, 1960, the taxpayer and Alfred filed a Form 1065, U.S. Partnership Return of Income, for 1957. The face of that return bore the note, "Income already reported on partners' returns for 1957." Under the depreciation schedule taxpayer's automobile was depreciated at $500, using the $2,500 cost as its basis. Taxpayer's partnership share of income was shown as $852.60, the same amount of profit which he reported on his 1957 individual income tax return theretofore filed as profit from his own business.

On June 8, 1960, taxpayer filed what was entitled "Corrected Return" for 1957 on Form 1040, which in all material respects conformed to the earlier return except that the amount of $852.60 was shown as income from partnership and no Schedule C was appended thereto.

During 1957 taxpayer and Alfred each held himself out as an individual accountant servicing clients in his own name. Each used a separate letterhead and rendered separate statements to clients. Each helped out with the other's work. Alfred had a number of clients. During 1957 taxpayer had only one account, Kaimuki Bakery, which paid $900 for the service.

Beginning on January 1, 1957, and continuing for about five months, taxpayer's car was utilized as a mobile office in which equipment was carried. Taxpayer and Alfred each operated from the car in working for private clients. About June, 1957, taxpayer and Alfred commenced sharing an office at Room 1, 1153 - 12th Avenue, Honolulu, Hawaii.

On June 1, 1957, a bank account was opened in the name of the taxpayer and Alfred. Payments made to each for accounting services were deposited in this joint account and expenses of maintaining the office were paid by checks drawn on this account.

There was no formal or written agreement between taxpayer and Alfred in regard to their arrangement and no prior binding agreement regarding distribution of income and expenses reflected in the joint bank account. Income and expenses were allocated at the end of the year, taking into account the assets of each party which had been utilized. Taxpayer received about 31 percent of the net proceeds in 1957. This percentage varied in subsequent years.

Aside from the Form 1065 filed in 1960 for calendar year 1957, as described above, taxpayer and Al-

fred did not file any partnership returns of income for any year subsequent to 1957, up to and including for the year 1961.

On the joint tax returns filed by taxpayer and his wife for the years 1958 to 1960, no partnership income was reported. In each of those returns a Schedule C was attached reflecting profit from the individual business of the taxpayer as a public accountant. Depreciation in the amount of $500 for the 1950 Plymouth automobile was claimed in addition to other business deductions.

During the years 1956 to 1960, inclusive, Alfred reported on his federal income tax return filed for each year as an individual the receipts from his business activities as a certified public accountant. No reference was made on any of these returns to the existence of any partnership, and no partnership income was designated thereon.

Taxpayer and Alfred each had his own separate accounting license to engage in business; each secured such license by virtue of a separate application submitted as an individual and not as a partner in a partnership.

Taxpayer and Alfred did not register as a partnership under Chapter 186, Revised Laws of Hawaii of 1955, which laws were in effect throughout the year 1957.

No partnership returns of income were filed by Alfred and taxpayer with the Department of Taxation of Hawaii. There is no record in the Department of Treasury and Regulation of a partnership doing business as Lawrence Au and Alfred Au.

In 1957, when taxpayer converted the automobile to business use, it had been operated for about 25,000 miles and was in good condition. In 1957, Plymouth automobiles of the model and type herein involved were being offered for sale in the Honolulu area, and could be purchased in good condition for lees than $650. The Official Guide used in the Hawaii area representing the average of used car prices reflected the average retail price of 1950 Plymouth automobiles at less than $650.

The fair market value of the 1950 Plymouth automobile was not in excess of $650 when it was converted to business use in 1957.

The court held that the taxpayer's basis for depreciation of the automobile was its fair market value at the time it was converted to business use. (R. 23-28.)

SUMMARY OF ARGUMENT

The taxpayer purchased a car, used it for personal purposes for about six years, converted it to business use, and is now seeking to take depreciation deductions on the basis of his original cost of the car. The Regulations and decided cases make it clear that the basis for depreciation of property purchased for personal use and converted to business use is the fair market value of that property at the time of its conversion. A holding that the depreciation basis is the taxpayer's original cost would have the effect of allowing him to deduct the expense of his personal use prior to the conversion from his business income

earned after the conversion since the car certainly depreciated physically as well as in value during his personal use; the Internal Revenue Code specifically forbids the deduction from income of personal expenses. The transfer of property to a partnership simultaneously with the conversion from personal to business use would not seem to affect the application of the Regulations and cases and the taxpayer has not shown why they should not apply.

The taxpayer's main point seems to be that the car had a fair market value of its original cost at the time of its conversion six years after its purchase. The only evidence offered in support of his position was the opinion testimony of his brother who did not purport to be an expert in car valuations. The Stipulation of Facts contained evidence that the fair market value of the car was less than the $650 basis allowed by the Commissioner as the taxpayer's basis for depreciation. Under these circumstances it certainly cannot be said that the Tax Court's findings of fact are clearly erroneous. The decision of the Tax Court should be affirmed.

ARGUMENT

The Tax Court Correctly Allowed the Taxpayer a Depreciation Basis for His Automobile of Its Fair Market Value At the Time It Was Converted From Personal To Business Use

The taxpayer acquired an automobile for $2,500 in 1951, used it solely for personal purposes for about six years, started using it in his business in 1957 (R. 19), and is now trying to use his original cost

as his basis for its depreciation. Allowing such treatment is contrary to logic, the decided cases and the Treasury Regulations; the Tax Court correctly allowed him depreciation on the basis of the fair market value of the car at the time he started using it for business use.

Section 167(a) of the 1954 Code (Appendix, *infra*), allows "as a depreciation deduction a reasonable allowance for exhaustion, wear and tear * * * of property used in the trade or business * * *." Section 167 (f)[1] (Appendix, *infra*) provides that the basis for depreciation of any property will be "the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property." Section 1011 of the 1954 Code (Appendix, *infra*) refers to Section 1012 (Appendix, *infra*) for "The adjusted basis for determining the gain or loss from the sale or other disposition of property * * *" and the latter section says that such basis "shall be the cost of such property * * *."

In *Heiner* v. *Tindle*, 276 U.S. 582, the Supreme Court interpreted one of the early predecessors to Section 1012. In that case the taxpayer converted his residence into rental property in 1901 and continued to rent it until he sold it in 1920. The Government argued that the applicable Regulations prohibited a deduction for any loss on the sale because

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[1] This provision was redesignated subsection (g) of Section 167 by Section 13(c)(1) of the Revenue Act of 1962, P. L. 87-834, 76 Stat. 960, for taxable years beginning after December 31, 1961, and ending after October 16, 1962.

the property was not (originally) acquired as business or income producing property. The Court held that loss, if any, would be allowed in the amount of the difference between the 1920 selling price of the property and the lower of its March 1, 1913, value or its value on the date it was converted to rental property. Applying the principles, if not the letter, of the statute and the Regulations, the Court held that (pp. 586, 587) "whenever needful the fair market value of the property at the time when the transaction for profit was entered into may be taken as the basis for computing the loss", and that the "transaction" was not the purchase of the property but its "appropriation" to rental purposes. In effect, the Court said that in the case of property converted from personal to business use, its value on the date of its conversion rather than its original cost would be used to determine the amount of loss. Also see this Court's decision to the same effect in *Spriggs* v. *Commissioner*, 290 F. 2d 181; *Parsons* v. *United States*, 227 F. 2d 437 (C.A. 3d); *Perkins* v. *Commissioner*, 41 B.T.A. 1225, affirmed *per curiam*, 125 F. 2d 150 (C.A. 6th). Cf. *Wood* v. *Commissioner*, 197 F. 2d 859 (C.A. 5th). Since under Section 167 (f), depreciation basis is the same as the basis for determining gain or loss, these cases require that the taxpayer's basis here be limited to the fair market value of his car at the time he converted it to business use.

In *Helvering* v. *Owens*, 305 U.S. 468, the Supreme Court held that a taxpayer could take a casualty loss

deduction of the amount of the difference between the fair market value of the property before it was damaged or destroyed and its fair market value after such damage or destruction rather than the difference between cost and value after the casualty as was provided for on the face of the statute and was contended for by the taxpayers. The Court said that the cost basis provided for by the statute contemplated reductions in basis for depreciation, and although no depreciation is allowable on property not used in a trade or business or held for the production of income, Congress intended that the deduction for any loss of such property be limited to the value of such property at the time of the loss. This was true even though, as in the instant case, the statute provided that the basis for determining the deduction was "cost." Section 167(f) provides that the same basis will be used for depreciation as is used for determining gain or loss on the sale of property. Under that provision the taxpayer's basis for depreciation here at the time he converted it to business use was the same as it would have been for determining any casualty loss and in the *Owen* case the Supreme Court said that that basis is the fair market value of the property at the time of the loss. It follows that here the taxpayer's basis for determining gain or loss of any kind and his basis for depreciation of his automobile must be its fair market value at the time it was converted to business use.

Consistent with these cases the following provision was added to the Income Tax Regulations in 1956 (Treasury Regulations on Income Tax (1954 Code), Section 1.167(f)-1 (Appendix, *infra*)):

Sec. 1.167(f)-1 *Basis for depreciation.*

* * * In the case of property which has not been used in the trade or business or held for the production of income and which is thereafter converted to such use, the fair market value on the date of such conversion, if less than the adjusted basis of the property at that time, is the basis for computing depreciation.

(26 C.F.R., Sec. 1.167(f)-1.)

This regulation is not only consistent with the cases discussed above, it is also consistent with Section 262 of the 1954 Code which provides:

SEC. 262 PERSONAL, LIVING, AND FAMILY EXPENSES.

Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

(26 U.S.C. 1958 ed., Sec. 262.)

Allowing the taxpayer to depreciate his car on the basis of his original cost in effect would allow him to deduct personal expense from his business income—if the entire original cost of the car here could be deducted through depreciation, then the business would be taking a deduction for the cost of wear and tear and depreciation in value of the car during the six years the taxpayer used it for personal purposes. The effect of this regulation and the cases discussed above is to disallow the deduction for depreciation and losses to the extent that they are attributable to personal use of property.

The taxpayer does not attack the Regulations or the cases cited above, but rather he tries to get around them by arguing that the conversion of the auto to business use at the time it was transferred to the alleged partnership somehow prevents them from applying to his car. Without getting into the logic problem of whether the "conversion" of property from personal to business use and the "transfer" of that property to a partnership may take place simultaneously, we submit that even if there was a partnership here in 1957, the logic of the Regulations and cases requires the conclusion that the basis for depreciation of the auto in the hands of the partnership was its fair market value at the time of its conversion to business use.[2] Cf. *Perkins* v. *Commissioner*, *supra*. Certainly the taxpayer has pointed to no reason or authority to explain why the established principles governing the basis of property converted from personal to business use should be inapplicable merely because the business use is that of taxpayer's partnership rather than that of taxpayer as an individual. Section 723 of the 1954 Code (Appendix, *infra*), says that the basis of property contributed to a partnership is the adjusted basis of that property in the hands of the contributing partner at the time

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[2] Although we believe the Tax Court's finding that the taxpayer did not prove that he and his brother were partners in 1957 is supported by the evidence in the record and therefore is not clearly erroneous, since we do not see how the existence or lack of existence of the partnership affects the outcome of the case we have not discussed the evidence supporting the Tax Court's finding.

of the contribution. This adjusted basis in the hands of the contributing partner is the basis the Supreme Court said in *Heiner* v. *Tindle*, *supra*, and this Court said in *Spriggs* v. *Commissioner*, *supra*, was the fair market value of the property at the time it was converted to income-producing use under the circumstances present here.[3]

The taxpayer's real complaint (Br. 25-30) seems to be that the Tax Court erred in finding that the fair market value of the automobile was $650 rather than the $2,500 value for which he is contending. The valuation of property is clearly a question of fact.

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[3] On page 13 of his brief the taxpayer quoted a part of a sentence in Treasury Regulations on Income Tax (1954 Code), Section 1.704-1(c)(1) in support of his position. The full sentence reads as follows:

> Sec. 1.704-1 *Partner's distributive share.*
>
> * * * *
>
> (c) *Contributed property*—(1) *In general.* * * * When the partnership agreement is silent as to the treatment of such items with respect to contributed property (and if such property is not an undivided interest as described in section 704(c)(3)), depreciation, depletion, or gain or loss with respect to such property shall be treated in the same manner as though such items arose with respect to property purchased by the partnership. * * *
>
> * * * *
>
> (26 C.F.R., Sec. 1.704-1.)

This sentence was clearly intended to be a guide for the allocation among the partners of deductions or gains of the partnership and does not purport to affect the basis to the partnership of the partnership assets; the basis itself is determined by Section 723 and Treasury Regulations on Income Tax (1954 Code), Section 1.723-1.

Treasury Regulations on Income Tax (1954 Code), Section 1.1001-1(a); *Penn* v. *Commissioner*, 219 F. 2d 18 (C.A. 9th); *Webster Investors, Inc.* v. *Commissioner*, 291 F.2d 192 (C.A. 2d). The Commissioner's determination of fact is presumptively correct and the burden of proving his determination wrong is on the taxpayer. *Clark* v. *Commissioner*, 266 F. 2d 698, 706 (C.A. 9th); Rule 32 of the Rules of Practice, Tax Court of the United States. Finally, the Tax Court's determination of a question of fact must be affirmed unless it is clearly erroneous. *Commissioner* v. *Duberstein*, 363 U.S. 278, 291; *Clark* v. *Commissioner, supra; Goldstein* v. *Commissioner*, 298 F. 2d 562 (C.A. 9th).

The taxpayer sought to carry his burden of overcoming the Commissioner's determination by offering testimony of his brother, who was also his alleged partner, that the car was in excellent[4] condition and was worth $2,500 at the time it was converted to business use. (R. 69, 73.)

In the first place the taxpayer's contention that a six year old car is worth as much as it was when it was new is preposterous on its face and is contrary to experience for the years in question. Furthermore, there was no contention that the taxpayer's brother was an expert on car valuations, and the Tax Court would not have been bound to accept his valuation even if he had been an expert. *Dayton P. & L. Co.* v. *Comm'n.*, 292 U.S. 290, 299; *In re Williams' Estate*,

[4] The taxpayer claimed a deduction for auto repairs in 1957 of $71.04. (R. 19.)

256 F. 2d 217, 219 (C.A. 9th); *Tracy* v. *Commissioner*, 53 F. 2d 575, 577 (C.A. 6th), certiorari denied, 287 U.S. 632; *Archer* v. *Commissioner*, 227 F. 2d 270, 273 (C.A. 5th).

The fair market value of property is "generally defined as that price which a willing buyer would pay a willing seller after negotiations in which neither party was acting under compulsion." *Goldstein* v. *Commissioner*, *supra*, p. 567. The "Official Guide," which listed the average retail price for used automobiles, and newspaper advertisements showed that a car of the make and model of the taxpayer's car could have been purchased in the Honolulu area in 1957 for an average retail price of less than the $650 allowed by the Commissioner as the taxpayer's basis for depreciation. (R. 14-15, 23, Exs. 19-S, 20-T, 21-U.) Thus the Tax Court's finding that the fair market value of the taxpayer's automobile was $650 is supported by the record, is not clearly erroneous and should be affirmed.

Finally, the taxpayer makes two procedural points in his brief. (Pp. 30-31.) First, he argues that the subsequent trade in of the automobile in 1961 (R. 16) renders moot the question of his basis for depreciation in 1957. He cites no authority for this proposition and it is clearly contrary to the statutes and Regulations cited above.

His second point is that the Tax Court erred in denying his motion for reconsideration. His brief gives no reason why he believes the Tax Court erred. Not only was his motion filed beyond the time allowed for filing such a motion without special leave of the

court (R. 30), which apparently was neither requested nor granted (Rule 19(e) of the Rules of Practice, Tax Court of the United States), but his motion contained nothing but his analysis of the applicable law and facts, both of which he had ample opportunity to explore at the original hearing. Under these circumstances the Tax Court did not abuse its discretion in denying his motion. Cf. *Bankers Coal Co.* v. *Burnet*, 287 U.S. 308; *Weiller* v. *Commissioner*, 64 F. 2d 480 (C.A. 2d).

CONCLUSION

The decision of the Tax Court should be affirmed.

Respectfully submitted,

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December 1963.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated:..............day of..., 1963.

....

STEPHEN B. WOLFBERG

APPENDIX

Internal Revenue Code of 1954:

SEC. 167. DEPRECIATION.

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * *

(f) *Basis for Depreciation.*—The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property.

* * * *

(26 U.S.C. 1958 ed., Sec. 167.)

SEC. 723. BASIS OF PROPERTY CONTRIBUTED TO PARTNERSHIP.

The basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution.

(26 U.S.C. 1958 ed., Sec. 723.)

SEC. 1011. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under section 1012 or other applicable sections of this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses)), adjusted as provided in section 1016.

(26 U.S.C. 1958 ed., Sec. 1011.)

SEC. 1012. BASIS OF PROPERTY—COST.

The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses). The cost of real property shall not include any amount in respect of real property taxes which are treated under section 164(d) as imposed on the taxpayer.

(26 U.S.C. 1958 ed., Sec. 1012.)

Treasury Regulations on Income Tax (1954 Code):

Sec. 1.167(f)-1 *Basis for depreciation.*

The basis upon which the allowance for depreciation is to be computed with respect to any property shall be the adjusted basis provided in section 1011 for the purpose of determining gain on the sale or other disposition of such property.

In the case of property which has not been used in the trade or business or held for the production of income and which is thereafter converted to such use, the fair market value on the date of such conversion, if less than the adjusted basis of the property at that time, is the basis for computing depreciation.

(26 C.F.R., Sec. 1.167(f)-1.)

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No. 18913

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

FRED A. ALEXANDER, LOUIS P. CAMAROTA, GEORGE CATHRO, ALBERT S. DIMOND, LEWIS FREEMAN, RANK MARANI, RAY C. MARVIN, JAMES NEWELL and EARL D. PETERSEN,

Appellants,

-vs-

PACIFIC MARITIME ASSOCIATION, a non-profit corporation; INTERNATIONAL LONGSHOREMEN'S & WAREHOUSEMEN'S UNION, an unincorporated association; SHIP CLERKS ASSOCIATION, LOCAL 34, ILWU, an unincorporated association; JOINT CLERKS LABOR RELATIONS COMMITTEE, SAN FRANCISCO, an unincorporated association; H. J. BODINE, L. B. THOMAS, WILLIAM CHESTER, K. F. SAYSETTE, J. A. ROBERTSON and HUBERT BROWN as Trustees of ILWU-PMA WELFARE & PENSION FUNDS; HARRY BRIDGES, H. J. BODINE, L. B. THOMAS, K. F. SAYSETTE, R. J. PFEIFFER, and CAPT. C. PRYOR as Trustees of ILWU-PMA MECHANIZATION FUND; DOES ONE thru TWENTY,

Appellees.

On Appeal from the United States District Court
for the Northern District of California
Southern Division

BRIEF FOR APPELLANTS

FILED

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Attorney for Appellants

No. 18913

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JURISDICTIONAL STATEMENT

This is an appeal from an Order of the District Court dated July 19, 1963, denying the plaintiffs' Motions for Sanctions, for failure to answer interrogatories ordered by the District Court. It granted a Summary Judgment for arbitration, and stayed all proceedings. The Order of July 19, is in effect a final and appealable judgment, made upon conflicting affidavits.

Goodall-Stanford, Inc. v. United Textile Workers, 353 U.S. 550, 11 L Ed 2d 1031, 77 S Ct 920.

Appellate jurisdiction of this court is based upon 28 USCA 1291. The plaintiffs' Federal Court jurisdiction is based on Sec. 301 of the National Labor Relations Act, 29 USCA 185, (Breach of Collective Bargaining Agreement), 28 USCA 1331 (federal question) and 28 USCA 1337 (commerce) and 29 USCA 301, et seq. (welfare and pension trust provisions).

If this order of July 19, 1963 (R-182) appealed from be considered an order under 9 USCA 3, Federal Arbitration Act (which has no application) or a stay of the plaintiffs' legal action under Sec. 301 pending arbitration, it would be an appealable order to this Court under 28 USCA 1292 (1). See Ross v. Century Fox Film Co., 9 Cir 1956, 236 Fed 2d 632.

This same case was before this court in ALEXANDER, et al., v. PMA, et al., No. 18324 decided February 28, 1963 in 314 Fed 2d 690.

The current appeal is from the District Court Order of July 19, 1963 (R-182). This order is a final judgment, and appealable (see Goodall-Stanford, Inc. v. United Textile Workers, 353 U.S. 550, 11 L Ed 2d 103, and this final judgment was made upon conflicting affidavits, and upon an alleged admittedly oral agreement (contended by defendants), and not upon a written contract, and this judgment was made without an opportunity for a trial upon the issues of fact.

STATEMENT OF FACTS

Upon the filing of the mandate with the District Court, upon the decision of this court, 314 Fed 2d 690, and pursuant thereto, the plaintiffs filed their amended complaint (R-20), an action upon the collective bargaining agreement in accordance with the decision of this court, and Doyle Smith v. Evening News Association, 371 U.S. 195, 9 L ed 2d 246. Plaintiffs had filed interrogatories under Rule 33 in September, 1962, and they re-filed to start the running of the time on April 26, 1963 (R-54). These interrogatories (R-6) sought to determine the sources of evidence available for discovery, and many were addressed to the evidences of the collective bargaining agreement, the portions in writing, and the portions the defendant claimed were oral, and the persons having knowledge thereof, and the portions the defendants claimed were based on customs, etc., and the persons having knowledge thereof to take the testimony upon oral depositions; the persons who were trustees of

the various funds under the agreement, and related matters such as registration, and the correlation between registration and membership in the defendant union, Local #34.

On May 10, 1963, the Honorable W. P. Sweigert, United States District Judge (R-84) made his order requiring the defendants to answer these interrogatories. This order on page 3 (R-86) held:

> "An examination of the interrogatories addressed to defendant Pacific Maritime Association, reveals that they are relevant to the issues framed in the plaintiff's amended complaint.
>
> The Court also considered the defendants' objections to the interrogatories as continuing. However, in view of the decision of the Court of Appeals and the decision in Smith vs. Evening News Assn., Supra, the amended complaint can no longer be considered as "practically identical" with the state action. The original complaint filed in the United States District Court charged defendants with discriminatory conduct; the amended complaint alleges a breach of a collective bargaining agreement. The relevancy of the interrogatories is to be determined under the amended complaint."

On May 1 and 8, 1963 and on June 10, 1963, the deposition of J. PAUL ST. SURE, President of PMA, was taken to determine the contentions of the defendant PMA as to the various matters, particularly the collective bargaining agreement covering clerks, and to discover the other matters that were within this PMA official's knowledge, and to discover the source of documents and other witnesses who could be examined upon oral depositions. This transcript with exhibits, of MR. ST. SURE'S deposition, is a part of this record,

and was considered by the United States District Judge in making his order on appeal (R-56).

On June 7, plaintiff's counsel noticed a Motion for June 17 to impose sanctions for failure to answer the interrogatories under Rule 33, pursuant to the written order of Judge Sweigert of May 10, 1963 (R-131). The first part of the order appealed from, of July 19, 1963 (R-182) summarily denies this motion, and in addition it makes a judgment, clearly appealable, staying all proceedings, under the defendant's motion for summary judgment, and stay pending arbitration. The order appealed from of July 19, 1963 (R-182), further orders that all remaining motions submitted by the defendants be stayed pending disposition of the case on arbitration.

The amended complaint (R-20) is one for breach of the collective bargaining agreement. The first count alleges that the defendant ILWU is an unincorporated association and labor union, with its principal place of business in San Francisco, and was a plaintiffs' agent for hire, and that said union is the exclusive bargaining agent under 29 USCA 151 et seq. It alleges that PMA is an unincorporated association, with its principal place of business in San Francisco, and that it conducts business as such for its members who are employers of ship clerks in the Port of San Francisco. The amended complaint alleges that there is a collective bargaining agreement covering the hours, compensation, and working conditions and terms of employment of ship clerks on the Pacific Coast, including the Port of San Francisco, and the agreement is wholly in writing

and executed by the defendant ILWU as bargaining representative; that the agreement consists of eleven documents enumerated in the amended complaint, commencing with the "Master Agreement for Clerks, etc." of April 1952. The amended complaint quotes the provisions of the Master Agreement, that it cannot be amended, modified, changed, altered or waived, except by a written document executed by the parties.

The amended complaint alleges this agreement not only provides for hourly pay as part of the individual compensation, but also provides for deferred contingent compensation in the form of monies paid into trust funds within the provisions of 29 USCA 186 and 301, et seq. It alleges that one of the provisions of the collective bargaining agreement is the payment of the employer to the welfare and pension funds for the benefit of all employees in the industry, upon each hour of work performed by each clerk employed under the agreement, including each individual plaintiff's employment. The amended complaint (R-22) alleges there is paid by the employers of each employee, including the plaintiffs, (and disbursed by the defendant PMA for its members) annual vacation pay to those on the regular working force who have worked 700 hours or more in the preceding calendar year. It is also alleged that a part of the compensation under this contract is to be paid into the Mechanization Fund under the provisions of the Federal law applicable to employee trust funds, the lump sum of $1,500,000 on or about June 15, 1960,

and an annual contribution of $5,000,000, payable in June each year, for each of the following 5-1/2 years, which fund is for the purpose of providing death benefits or retirement funds if the employee lives to retirement, and to guarantee employment at straight time pay for 35 hours each week for each person in the permanent working force of the maritime industry of the Pacific Coast, who were so employed in 1958.

The amended complaint (R-23) alleges that the ship clerks in the Port of San Francisco are engaged in the flow of interstate and foreign commerce through the Port of San Francisco, and that the plaintiffs were and are full-time employees for a varying period for each of the nine plaintiffs from six to twelve years; that each of the plaintiffs worked for said years, and each is now available for such work, and each is skilled as a ship clerk, and a member of the permanent working force of the ship clerks in the Port of San Francisco, and is dependent chiefly upon the employment as ship clerk for his livelihood, and was and is available for dispatch on ordinary working days during ordinary working hours, from the hiring halls maintained under the bargaining agreement.

The amended complaint alleges that under this agreement, there was and is created an unincorporated association, one-half of the members are selected by the employer, and one-half by the union, known as the Joint Clerk Labor Relations Commitee, San Francisco, and this defendant COMMITTEE acts by one vote for the

employer and one by the union, and both votes are necessary for action by the committee, and this defendant COMMITTEE runs and maintains the two hiring halls from which ship clerks are dispatched and has control of the "registration" lists in the Port of San Francisco, making additions and subtractions thereto.

The amended complaint (R-24) alleges that the bargaining agreement contains provisions that those who constitute the full-time working force and depend upon this work for their livelihood are designated as "registered" ship clerks to distinguish them from those who are only seasonal or occasional members of the working force of ship clerks and who depend upon other employment for their principal livelihood. The amended complaint sets forth hoc verba the relevant portions that registration shall be by "mutual consent;" it permits either party, PMA or ILWU Union to demand additions or subtractions as may be necessary to meet the needs of the port; and when objecting to any registration, the member of the COMMITTEE shall give his reasons therefor. It provides that when men are dropped from the list, it is done on a seniority basis. There is also set forth hoc verba, the provisions of the contract granting preference to registration. It also alleges hoc verba, the portions of the contract granting preference of employment and dispatch to those who were registered on June 1, 1951. It also quotes hoc verba from the contract, that there shall be no favoritism or discrimination in hiring or dispatching. It sets forth hoc verba, the provision that no one shall be dispatched as a clerk, while any clerk on the registered list is

qualified, ready and willing to work. The amended complaint also sets forth hoc verba the provision in the collective bargaining agreement that there shall be no discrimination against any person by reason of membership or non-membership in the union. The amended complaint also alleges that a portion of the written agreement as to registration requires there is to be maintained an adequate registered working force of ship clerks.

The amended complaint (R-26) alleges that the defendant LOCAL #34 is an unincorporated association, and the defendant ILWU both act as agent for hire and compensation therefore by the plaintiffs, and as exclusive bargaining agents, and this Local is delegated the administration of the agreement in the Port of San Francisco, and is employed by the plaintiffs as an agent for hire and compensated therefor.

The amended complaint (R-26)sets forth that the defendant LOCAL #34 selects and directs the employee member of the defendant Joint Committee; that without the vote of the employee member, no person can be registered as a ship clerk by the defendant COMMITTEE, and that by this mechanics LOCAL #34 has prevented additions to the names of registered ship clerks in the Port of San Francisco, notwithstanding the provisions as to registration and provisions for an adequate working force, and the defendant Union by withholding the approval to individual registration has and does now limit the number of names enrolled as "registered" to approximately one-half of the total persons constituting the full-time working force, and to the number needed to constitute an adequate working force. It alleges

that during the existence of the agreement to the present time, this defendant UNION through its representative on the COMMITTEE, arbitrarily restricts its consent involving fully registered ship clerks, solely to applicants who are full-book members of LOCAL #34 in violation of the terms of the agreement, and in violation of the duty as plaintiffs' agent for hire and as statutory collective bargaining agent.

The amended complaint (R-27) sets forth that the defendant ILWU and the defendant LOCAL #34 and the employee members of the defendant COMMITTEE violate the provisions of the contract against discrimination by acts of planned, purposeful and hostile discrimination against the plaintiffs for the sole reason that the said plaintiffs and each of them were not and are not now full-book members of the defendant Unions or either of them, although the plaintiffs and each of them have sought membership therein as full-book members, are qualified for such membership, and would be members except for the arbitrary refusal of the said Unions, and each of them to admit the plaintiffs who have complied with all conditions precedent for such membership.

The amended complaint (R-27) alleges that the defendant UNION and the employee members of the defendant COMMITTEE have breached the collective bargaining agreement by failure to enter on the COMMITTEE'S list of "registered" ship clerks in the Port of San Francisco the plaintiff's names, by failure to dispatch the plaintiffs without discrimination, and by failure to maintain the list of ship clerks at an adequate number as in the contract provided. It is also alleged that the defendant COMMITTEE has breached said agreement by failure to

register an adequate number, notwithstanding demands by the employer for an adequate registration of ship clerks in said port, and said breaches in each of them were done to grant preference to those ship clerks who are full-book members of LOCAL #34.

The amended complaint (R-27) alleges that the written bargaining agreement in effect on June 1, 1951 was a bargaining agreement known as the Pacific Coast Longshore Agreement dated 6 December 1948, and supplemented by the ship clerk's agreement of January 17, March 11 and March 25, 1949, which by its terms granted and gave preference of registration and employment to LOCAL #34 union membership. As a result thereof, only union members were fully "registered" as ship clerks on June 1, 1951. That the said prior written collective bargaining agreement in effect on June 1 of 1951 was determined illegal and void in proceedings involving the UNIONS in 90 NLRB 1021, 98 NLRB 284, and the adjudication of the Ninth Circuit in 211 Fed 2d 946 by reason of said preference of employment and registration. These adjudicated illegal provisions in effect on June 1, 1951 are blanketed in and carried into the current bargaining agreement by the seemingly innocent seniority date of June 1, 1951 and the granting of priority of employment dispatch to those registered. This illegal provision is further carried out by the defendant COMMITTEE'S refusal to approve sufficient registrations in the port, and to arbitrarily restrict all registrations since that date to full-book union membership in LOCAL #34. That by keeping the registrations to approximately one-half of the full-time working force dispatched from day to day,

and by keeping "registration" coextensive with full-book LOCAL #34 membership, the union members are dispatched from the hiring hall under priority, and keep employment under this priority, and as consequence obtain and hold by priority of employment the more sought after, and the far more profitable employment as ship clerks. This giving of the uncontrolled discretion to the UNION through its employee member of the defendant JOINT COMMITTEE "in consent" to registration of ship clerks by requiring "mutual consent" of both the employer and the employee member to each individual registration, is illegal and void.

The amended complaint (R-29) alleges that within the four years last past on numerous occasions and on June 26, 1962, each of the plaintiffs duly and regularly requested that he be duly registered as a ship clerk and enrolled as such on its records under the bargaining agreement. The defendant COMMITTEE wrongfully refused and failed without just cause or excuse to enroll the plaintiffs or any of them as registered ship clerks, but registers others who joined the working force of ship clerks subsequent to the plaintiffs in violation of the agreement. It alleges that the plaintiffs DIMOND, FREEMAN and NEWALL were at one time "registered" in the maritime industry, and were deregistered without cause, and without notice by the defendant UNION arbitrarily removing their names from the list of "registration," probably for want of union membership in LOCAL #34. It is alleged that the plaintiffs are entitled to "registration" in preference therefore under the contract which is violated by the defendant UNION'S failure

to follow said contract provisions. It alleges that the defendant COMMITTEE has and does now fail and neglect to make the ministerial act of entering the plaintiff's name in the r egistration list of full-time ship clerks employed in the Port of San Francisco to designate each as a member of the permanent working force as provided in the contract. It further alleges that at no time when applications for "registration" or requests for "registration" were made, did the JOINT COMMITTEE or any of its members ever state to the plaintiffs or any of them, or otherwise, any grounds or reasons or objections to any of the plaintiffs' registration as provided in the contract, and did thereby breach the contract.

Amended complaint (R-30) sets forth that each of the plaintiffs is a party to the collective bargaining agreement, and the agreement was made for the benefit of each. That this collective bargaining agreement is incorporated in and made a part of each of the plaintiff's employment on each individual dispatch as such ship clerk. It alleges that the plaintiffs have duly and regularly contributed their portion of the maintenance of the hiring hall as provided in the contract, and that as part of the contract of hiring of the defendant UNION S by the plaintiffs, plaintiffs have duly paid and contributed assessments for "caucuses and representation" to the defendant ILWU and the defendant LOCAL. These assessments and contribution are identical with and varies from month to month with the full-book LOCAL 34 members dues and assessments. Actually, the plaintiffs pay identical sums to the UNION under this assessment for maintenance of hiring hall and other union assessments as full-book

members pay for dues and assessments, although they are not full-book members, nor permitted this membership.

The amended complaint (R-30) alleges that in addition to the so-called "preferred" employees employed on a monthly basis, who are for the most part supervisory employees in the maritime industry, and who are full-book members of LOCAL 34, there are approximately 450 men who constitute the full-time working force of ship clerks in the Port of San Francisco available for and normally dispatched from day to day from the two hiring halls in the Port of San Francisco under the collective bargaining agreement. The amended complaint alleges that 235 of the 450 are "registered" and are also full-book members of LOCAL 34, and that approximately 215 of the permanent working force, or 48%, including the plaintiffs, are nonetheless full-time employees and members of the working force, but are arbitrarily discriminated against and not "registered," nor are they permitted this full-book union membership. It is alleged that the defendant LOCAL 34 has determined that there is and has existed a necessity for a substantial increase in the number of registered ship clerks in the Port of San Francisco, but for the purpose of maintaining this preference for its full-book members as part of this planned, purposeful and hostile discrimination against the plaintiffs, both as the statutory bargaining agent and as plaintiffs' agent for hire, in violation of its contractual duty as such agent for hire, said LOCAL has and does now violate the said contract by both refusing to follow the terms of the said bargaining contract as to registration and preference therefor, and also to maintain an adequate working force as provided by

the written agreement.

The amended complaint sets forth a second cause of action (Declaratory Relief) starting at R-31, and re-alleges the first cause of action, par. 1 through 18. It then alleges that the plaintiffs are informed by the various shipping companies and stevedoring companies as their individual employers, to which the plaintiffs have been and are now being dispatched, and that such employers who are members of the defendant PMA, pay to PMA the full compensation provided by the collective bargaining agreement on each of the plaintiff's employment, including the so-called "Eight-hour Rule," the welfare and pension payments generated and computed on an hourly basis on each of the plaintiff's services, and payments for the Mechinization Fund, by each of the employers, upon the plaintiff's work; and for vacation pay under the collective bargaining agreement on each of the plaintiff's hours of work in their said individual employment. The defendant PMA, although collecting this money from the individual employers, does not pay the plaintiffs according to the collective bargaining agreement, but on the contrary PMA pays the full-book members of LOCAL 34 according to the contract, but does not pay the plaintiffs or any of them such compensation remitted by the employers for their work, in the event the hold of the ship is loaded or the plaintiffs' individual dispatch is terminated prior to eight hours, in accordance with the "Eight-hour Rule," wherein a ship clerk is paid for eight hours of work if he works on any single day more than four hours but less than eight. It is alleged that the plaintiffs are informed through their counsel by counsel for PMA that the Welfare and Pension Fund contributions are

immediately remitted by PMA to the defendant trustees for the fund, including monies contributed by the plaintiffs' individual employers. It is alleged that defendant PMA does not pay any portion of the vacation pay or the Mechanization Funds to the plaintiffs or for their use or benefit.

The amended complaint (R-32) sets forth the individual defendant members of the Welfare and Pension Fund, and that this Welfare and Pension Fund was to be used for the benefit of all persons working under the collective bargaining agreement, including the plaintiffs, and the trust terms thereof and the collective bargaining agreement provide for the purchase of contracts of insurance for each of the employees including the plaintiffs, and to pay group medical, surgical and hospital benefits under the Kaiser-Permanente Health Plan for all employees including the plaintiffs and their immediate families, and for dental benefits for dependent children of such beneficiaries, and for supplementary maternity benefits for such beneficiaries. The amended complaint alleges that these payments were made and the benefits furnished the plaintiffs until 1958, when the defendant TRUSTEES breached the contract, and thereafter failed, refused and neglected to either purchase the insurance contracts or the group hospital, medical and surgical and other benefits for the plaintiffs, or any of their dependents. It is further alleged that on February 28, 1962, the defendant ILWU in violation of its duty as plaintiffs' agent for hire and its duty as exclusive collective bargaining agent for all ship clerks including the plaintiffs, agreed with the defendant PMA, who well knew of this violation of duty, to amend the Welfare and Pension Fund portions of the collective bargaining agreement

retroactive as of June 1, 1961, so that only an arbitrary portion, to wit the 52% of the ship clerks who were full-book members of LOCAL 34, would receive all of the benefits of such trust. It is alleged that this is a violation of the Federal statutes applicable to such Welfare and Pension Funds, and the defendant TRUSTEES have and do now use said funds including the compensation generated upon the plaintiffs' services from their individual employers for only the 52% of the ship clerks who have full-book membership in LOCAL 34, and not for all employees in said working force.

Amended complaint (R-33) alleges the defendants who are trustees of the Mechanization Fund. It is alleged there has been created for the purpose of violating the said contract, two funds consisting of the said defendant trustees designated as trustees of the "Vesting Benefit Fund," and the same defendants as trustees of the "Supplemental Wage Benefit Fund," an unfunded trust. It is alleged that in violation of the contract, PMA disburses directly to 410 individuals; nevertheless the defendant trustees stating in their report to the Department of Labor, that there are 1390 more who will be eligible but are not currently receiving benefits, and such funds are disbursed in the name of the trustees from the accounting office of PMA at 16 California Street, San Francisco, to said unknown 410 beneficiaries. It is alleged that the defendant PMA has disbursed in the defendant trustee's name and in violation of the contract, during the year 1960, the sum of $3,000, and during the year 1961, $7,521.40, and during the year 1962, $814,870 in the name of the trustees as disbursements under said "Vesting Benefit Trust Fund" as an "unfunded plan," and that the defendant PMA has disbursed to the said trustees who purport to hold under "Supplemental Wage Benefit Fund" in 1960 $784,500 and in 1961 $1,786,341.20 and in 1962 the sum of $524,101

That no part of said "Supplemental Wage Benefit Trust Fund" has been or now is being disbursed or paid to any person. It is alleged in the amended complaint that in violation of the collective bargaining agreement, these defendant trustees have not paid the plaintiffs any part, although the plaintiffs have not, by reason of other breaches of the contract herein set forth, had the 35 hours of minimum work, and are entitled to benefits therefor for some months prior to this action.

It is alleged in the amended complaint (R-34) that the balance of the $11, 500, 000 Mechanization Fund payable to and including June 1962 is held:

a. By the Welfare Fund trustees in the sum of $3, 670, 926, in contravention of the agreement, but for the purposes of the Mechanization Fund under the October 18, 1960 Supplement Agreement;

b. By defendant PMA in the sum of $3, 040, 170, unpaid in contravention and in breach of the agreement, but nevertheless collected under said collective bargaining agreement from its members for work performed by the plaintiffs and others in the maritime industry, and said sum is held by the defendant PMA in contravention of and in violation of both the contract and the Federal statutes applicable to Welfare Funds.

Amended complaint (R-34) sets forth that the Mechanization Agreement Supplement dated October 18, 1960 provides for payment of $1, 500, 000 payable by the employers in 1960, and $5, 000, 000 per year payable each year subsequent thereto, for a period of 5-1/2 years, and provides that the fund shall be used solely for the benefit of the full-time working force of the maritime industry including ship clerks employed in 1958, of which the plaintiffs are part, for the

purpose of guaranteeing full-time employment and straight pay to all in the group, and to provide death benefits of approximately $5,000, a voluntary retirement benefit of approximately $7,950 upon retirement. It is alleged that the defendant UNION in violation of its duty as a plaintiffs' agent for hire and compensation by the plaintiffs, and as exclusive bargaining collective agent for all ship clerks, both union and non-union, with full knowledge of the defendant PMA of said employment, and said duty as such agent, made as a part of said agreement of October 18, 1960, a provision that said benefits would not be used for all employees employed in 1958, but would be arbitrarily restricted to those employees designated as "registered" and thereby exclude benefits from the plaintiffs and all other non-union employees; and that said restriction is in violation of the Federal statute applicable to such funds.

Amended complaint (R-35) sets forth that by the mechanics and practices set forth in this complaint, the defendant COMMITTEE and the defendant UNION violated and breached the collective bargaining agreement as follows:

1. By discriminating against the plaintiffs and others who were and are non-union employees in both "registration" and dispatch in violation of the specific terms of the contract;

2. By failure to maintain the number of "registered" at an adequate number to provide adequate working force of ship clerks in the Port of San Francisco on such registered list, in order to give preference to said full-book members of LOCAL 34;

3. By making "registered" coextensive with said defendant ILWU, LOCAL 34, full-book membership.

4. By failure to meet the demands of the employers for an adequate registered working force;

5. By giving priority of dispatch to those who are full-book members of LOCAL 34 in violation of the terms of the contract;

6. By limiting the selection of employee members of the defendant COMMITTEE solely to votes of those who were full-book union members, and permitting only full-book members of LOCAL 34 to vote.

7. By restricting the election of the dispatchers who actually hand out the individual jobs in each of the hiring halls on each dispatch, to dispatchers selected solely by an arbitrary group limited to those who are full-book members of LOCAL 34, and not permitting the plaintiffs and others who are not full-book members to vote for or take part in the selection and election of such dispatchers;

8. By keeping in effect "registration" of ship clerks who were "registered" under the illegal provisions of the prior contract, so held illegal as to such union membership preference of registration and employment;

9. By violating the contract and by not following the provisions as to preference and priority and provisions as to registration, the said defendants grant an unlawful preference in dispatch and employment to those having this arbitrary and unlawful preference, and in addition, said defendants do not dispatch equally and without discrimination all of those qualified and eligible under the contract, including the plaintiffs.

Amended complaint (R-36) sets forth that the ILWU in violation of its duty as agent for hire and compensation paid by the plaintiffs, and its duty as an exclusive bargaining agent to act impartially for all employees,

both union and non-union, and with knowledge of the defendant PMA of the defendant's said violation of its duties. Said defendants provide in the collective bargaining agr eement that all matters of arbitration and mechanics for handling of grievances in connection with registration, dispatch, and all other matters are denied and prevented the plaintiffs and each of them who are not "registered" as ship clerks by the said defendant COMMITTEE.

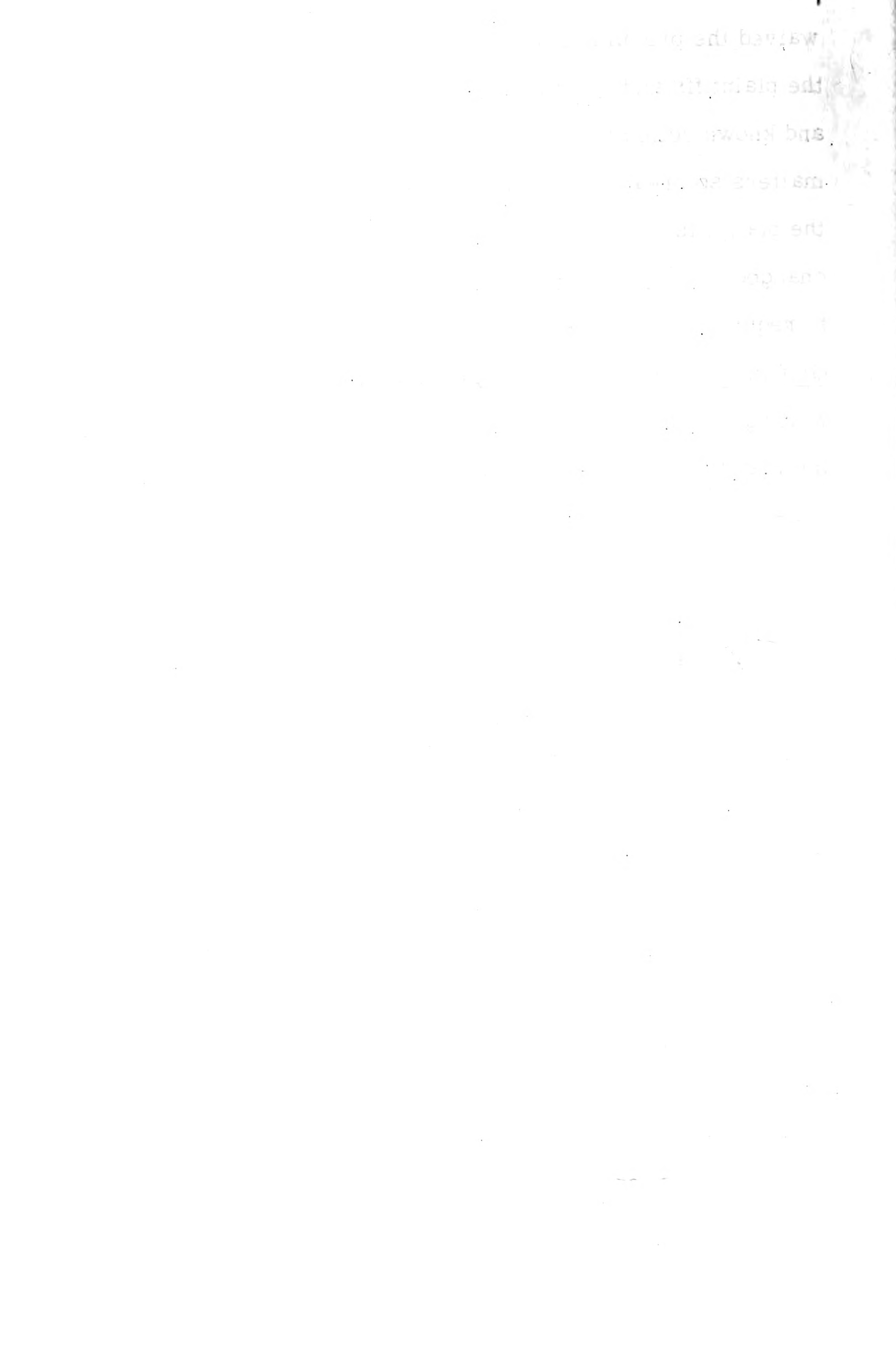
It alleges that on June 26, 1962 each of the plaintiffs, through their counsel, wrote each of the defendants, and in writing requested that if they or any of them knew of any mechanics for grievance or arbitration in the collective bargaining agreement covering any matters in dispute, the plaintiffs would welcome the mechanics of arbitration to solve these disputes or any phase of them. That the defendants and each of them refused to reply to said communication, and the plaintiffs filed this action on August 13, 1962.

Amended complaint (R-37) sets forth a justiciable contraversy between the plaintiffs and the defendants and each of them concerning the terms of employment, dispatch, compensation, and the said collective bargaining agreement, and the rights and duties thereunder arising from the breach of the contract as follows:

1. Plaintiffs contend the bargaining agreement consists solely of the written documents aforesaid, on the contrary the defendants and each of them contend the bargaining agreement is subject and is changed and added by secret oral understandings between ILWU and PMA, and is not confined to the written memorials constituting the bargaining agreement, and the defendants and each of them have by their continued breaches

waived the provisions of the contract, not only as to the matters which the plaintiffs and their individual employers relied upon as the disclosed and known collective bargaining agreement in each dispatch, but as to all matters so breached by the defendants' unlawful conduct. In this respect, the plaintiffs contend that the provisions of the contract requiring it to be changed only by writing, is a sufficient demand under the Taft-Hartley Act to require any changes to be reduced to writing; and that the Landrum-Griffin Act requires the entire collective bargaining agreement to be in writing, so that it may be inspected and known by the employees including the plaintiffs, otherwise the provisions of Congress in said Act are meaningless.

2. The plaintiffs contend that each of them under the collective bargaining agreement, as members of the full-time labor force of ship clerks available for dispatch from the hiring halls in the Port of San Francisco, were and are entitled to the status of "registration" as provided by the bargaining agreement, and that the failure to enter their names on the "registration list" is a breach of the contract. Plaintiffs further contend that discrimination against them as non-union ship clerks is a violation of the collective bargaining agreement, and the plaintiffs contend that in making "registration, " the defendant COMMITTEE must follow the priorities therefore in said agreement, and failure to do so is a breach of the contract. Plaintiff contends that the collective bargaining agreement requires an adequate number of "registered" ship clerks, and failure to maintain this number is a breach of the contract. Plaintiffs contend that upon demand of the employers to increase the number of ship clerks in the Port, a failure to increase such number is a violation of said contract,



and on the other hand, the defendants and each of them contend there are two classes of employees, those which the defendant COMMITTEE designates as "registered" and who constitute approximately one-half of those in the permanent working force dispatched from the two hiring halls, and who by this mechanics and practice receive special preference and who receive greater compensation, whereas the plaintiffs and others are subject to discrimination and are compensated at a lesser rate.

3. The plaintiffs contend that the current collective bargaining agreement is invalid insofar as it blankets in and perpetuates the "registration" in effect on June 1, 1951, made under the illegal provisions granting preference of employment and registration to union members, so held invalid by the NLRB and adjudicated void and illegal by the Ninth Circuit Court of Appeals. On the contrary, the defendants and each of them contend that said provisions in the current bargaining agreement granting preference are valid and binding, and registrations made under the illegal provisions of the prior agreement, confined to union membership, remain in full force and effect.

4. Plaintiffs contend they and each of them are entitled to equal dispatch from the hiring hall under the valid terms of the bargaining agreement, without discrimination and equally under said agreement, and without discrimination by reason of lack of union membership, by express provision of the collective bargaining agreement. On the other hand, the defendants and each of them contend that the hiring halls and their facilities under the provisions of the said bargaining agreement shall be and are used to grant preference to those whom the COMMITTEE arbitrarily enters on the list as "registered" irrespective of the requirements of preference

of registration in the agreement. In this respect, the defendant COMMITTEE, the UNIONS and PMA contend that the agreement requires and authorizes them to dispatch ship clerks to jobs in the following order of preference, and for retaining employment on this basis:

a. Fully registered (Class A) ship clerks "registered" on June 1, 1951 (under the prior contracts void because of preference of registration to LOCAL 34 full-book members);

b. Fully registered (Class A) ship clerks "registered" since June 1, 1951 whether under the prior invalid agreement, or under the present agreement;

c. Other "registered" ship clerks (designated by the defendant COMMITTEE as Class B);

d. Longshoremen, members of LOCAL 10, ILWU, who on that particular date have either not been dispatched or did not choose to be dispatched as Longshoremen, and who are physically present in the clerk's hiring hall;

e. Such other persons, whether experienced or not, as a dispatcher elected as aforesaid may, for reasons personal to the individual dispatcher choose to dispatch, even though members of the full-time working force including the plaintiffs are available in the hall for dispatch;

5. Plaintiffs contend that they as parties employing and compensating such agents, the defendant ILWU and the defendant LOCAL, and as non-union ship clerks represented by the said defendants as the exclusive bargaining agent under the Taft-Hartley Law, are entitled to be represented in such bargaining agreement negotiations and in the administration of the collective bargaining agreement, without discrimination, faithfully and

equally, according to the laws applicable to agents for compensation for hire, and according to the rules applicable to statutory collective bargaining agents, and that any abuse of this fiduciary relationship to obtain preference for any group or class of employees, or any planned, hostile and purposeful discrimination against the plaintiffs as such principals, under a contract for hire, or as either employees or as non-union employees, is improper and the plaintiffs are entitled not only to their action at law for breach of the duty, but the Court will and must protect the plaintiffs in the construction and enforcement of the collective bargaining agreement from such abuse and from such acts of the defendants. That the PMA deals with the UNION in making changes in the administration of the collective bargaining agreements, well knowing that the defendant UNIONS are both agents for hire, compensated by the plaintiffs, and also the employees' exclusive bargaining agent, and that the authority of such agents are limited accordingly, and that any contracts it makes with such knowledge and any such transactions it makes in the administration of the collective bargaining agreement, is done with knowledge of each agent's limitation of authority. On the other hand, the defendants and each of them contend that their actions, though they grant unconscionable and unlawful preferences by this mechanics in preference of jobs, and in compensation for work performed thereunder, and that their actions permit the selection and election of employee members of the defendant COMMITTEE, and of hiring hall dispatchers only by approximately one-half of the working force, and prevents the use of arbitration or grievance machinery in all matters involving the plaintiffs, is nevertheless valid, and the plaintiffs and none of them have any right in equity or in law to demand the ILWU to perform its duty as an agent for hire compensated by the plaintiffs, or

as exclusive collective bargaining agent under the Taft-Hartley Act, nor as agents under any fiduciary duty.

6. Plaintiff contends that they are entitled to the contract pay and compensation as ship clerks, as set forth under the collective bargaining agreement, whether or not the defendant COMMITTEE has made the actual act of entering the plaintiff's name as "registered" on the committee's list, and particularly the right to be paid according to the bargaining agreement under the Eight-hour Rule, and for the deferred continued compensation under the Welfare and Pension Fund, and that any attempted retroactive change in the agreement is void and under Federal law applicable to such funds, such benefits cannot be restricted by any mechanics, solely to those having full-book membership in LOCAL 34. Plaintiffs contend that all benefits including wages generated on their individual employment cannot be paid into a fund to be used exclusively for such union members, and they further contend that the sums and benefits accrued under the attempted change in February 1962 are benefits to which the plaintiffs and each of them are entitled by express terms of the collective bargaining agreement. Plaintiffs contend that the Mechanization Fund monies are considerations for contracts made for and on behalf of the plaintiffs and all other employees, and that monies generated on the employment of the plaintiffs and all other employees entitle the plaintiff and all of the employees to their equitable interest in the funds and to the benefits thereunder, and that said benefits cannot be restricted in violation of Federal statute, solely to employee-union members. Plaintiff and each of them claim they are entitled to the vacation pay under the collective bargaining

agreement, each having worked for the necessary hours in each year. On the contrary, the defendants contend that the plaintiffs solely because of said defendant COMMITTEE'S failure to enter the plaintiffs' names on the list of "registered ship clerks" and said COMMITTEE has only entered as registered, an arbitrary part of the working force restricted to those having full-book union membership, the plaintiffs are not entitled to any of the deferred contingent or other benefits to be paid under the collective bargaining agreement, but that PMA may and does keep for itself any funds from the individual employers for compensation on plaintiffs' labors, including funds for deferred contingent and other benefits for vacation pay and Mechanization Fund payments, and the trustees of the Welfare Fund can and does properly refuse to pay for or provide any benefits to the plaintiffs under the terms of the collective bargaining agreement, because they are not union and "registered" clerks. Said defendants of the Fund contend they properly use the funds only for union members to the exclusion of all other employees on whose work said funds were generated, earned and paid, including the plaintiffs.

7. Plaintiffs contend that there should be no discrimination by reason of age between the ages of 40 and 64 as provided in <u>1961 Statutes of California Chapter 1623</u>. on the contrary, the defendants and each of them contend that in "registration," making lists of regular working force of ship clerks dispatched with preference to jobs, they not only can but do consider such of the plaintiffs as are 50 to 64 years of age, and disqualify them solely by reason of age, but nevertheless the defendants do take other persons who are acceptable to LOCAL 34 into full-book membership, and do not disqualify them because of age, and register them and grant them

this preference, although some of these persons are between the ages of 50 and 64.

The amended complaint (R-43) alleges that the Mechanization Agreement supplement has and does now reduce the amount of work available, and that as a result of the discriminatory practices against the plaintiffs in violation of the contract, and the said improper construction of the bargaining agreement, since the Fall of 1961, the plaintiffs and each of them are now dispatched only occasionally as such ship clerks from the hiring halls.

The third count is alleged in the amended complaint (starting R-43), and it re-alleges the allegations of counts one and two. It sets forth the payment to PMA by the individual employers of the plaintiff, according to the collective bargaining agreement, including all fringe benefits (deferred contingent compensation), but that the funds are paid to the PMA are not entirely used for the plaintiffs, and that PMA has only paid and disbursed portions to the plaintiffs or for their use. The plaintiffs seek to impress the trust upon such of the funds as are in hands of such defendants, and that a demand has been made upon the various defendants for an accounting, and the defendants have and do now refuse and neglect and fail to account for the funds or any part thereof, or use the same according to the collective bargaining agreement for the purposes for which it was paid, or to the plaintiffs.

It is alleged in the third count (R-44) that within four years last past, each plaintiff has suffered damages by breach of the contract in the sum of $5,000 per year, which is the difference in each one's earnings, had each been dispatched and paid under the contract, and they pray leave

to amend their complaint and set forth the exact sums when they are ascertained upon discovery.

The fourth cause of action (R-44) re-alleges the first two counts and sets forth that the use of "registration" of employees is novel to the maritime industry and used originally to designate employees in the industry of full-time employees dependent thereon for their livelihood as distinguished from those who are seasonal or parttime or dependent upon other employment during other parts of the year for their livelihood, and this is the provision of the current written agreement. It alleges under the prior contract preference of dispatch and registration were given to those with union membership by express provisions in that writing. On April 6, 1961, an Examiner in proceedings before the NLRB made an interim report holding that the execution of the written collective bargaining agreement was in and of itself an unfair labor practice because of the union membership preference. As a result thereof, the defendant PMA and the defendant ILWU re-negotiated the basic contract providing for the priority of employment and dispatch to those "registered" as of June 1, 1951 under the illegal provisions for prior registration, in order to defeat and avoid this determination of the NLRB. On February 26, 1952, the NLRB on the basis of the interim report directly determined the execution of the written contracts granting preference of registration and dispatch to union members was per se an unlawful labor practice. Thereupon the defendant ILWU and PMA, to defeat and make void the determination of the NLRB, re-negotiated the clerk's collective bargaining agreement on April 4, 1952 and executed the Master Agreement providing for said seniority date of June 1, 1951. That thereafter, in June of 1954, the NLRB

proceedings were reviewed by the U. S. Court of Appeals, Ninth Circuit, and in 211 Fed 2d 946, the provisions as to priority of registration and dispatch to union members was adjudicated illegal and void. And that for the purpose of frustrating and avoiding the 2 NLRB orders, and the U.S. Court of Appeals decision, the Master Agreement contain both the seniority dates of June 1, 1951 and the registration provisions requiring "joint consent" (arbitrary veto by the union through its selected and directed employee member) and the denial of all arbitration and grievance machinery to "non-union Non-registered" ship clerks, has not only been continued, but extended and kept in effect, well knowing the said purpose, and it was extended again by a writing dated June 29, 1962.

That although the collective bargaining agreement contains the express provisions against discrimination because of lack of union membership, the defendant PMA and ILWU and the defendant LOCAL 34, the defendant COMMITTEE, and the defendant trustees of the funds do now use the designation of "registration" not only to defeat the NLRB order, and the adjudication by confining "registered" ship clerks in the Port of San Francisco solely to such full-book members of LOCAL 34, and make the two terms of registration and full-book membership synonomous, but also to discriminate against the plaintiffs and all other full-time members (not union members) of the working force of ship clerks, in order to grant a preference to said union members, not only in dispatch and employment, but also to use the earnings in the Welfare and Pension Fund solely for full-book members of the union, and also to permit the defendant PMA to unlawfully divert to itself the vacation pay and parts of the Mechanization Fund, part of the hourly pay under the "Eight-hour Rule" of all non-union ship clerks in the Port of San Francisco in violation of the collective bargaining

agreement, and that to effect this unlawful design in contract violations, the defendants by their acts and conspiracy have done the following acts:

1. Maintained on the "registered" list of defendant Committee all union members "registered" under the prior illegal contract provisions.

2. Kept the "registered" number of ship clerks in the Port of San Francisco at said artificially low point to grant said preference of employment and dispatch and confine benefits under said jointly trusteed fund to said union members.

3. Breached the written contract provisions as to said Welfare and Pension provisions from 1958 to 1962 when said defendant PMA and defendant ILWU purported to amend the agreement retroactively to June 1, 1961, to confine all benefits to solely said union members by limiting it to "registered" ship clerks.

4. To admit to "registration", ship clerks in said Port, only those who are full-book members of the defendant LOCAL 34, ILWU, and said defendant UNION by its said employee members of the defendant COMMITTEE, limits its consent and vetoed all other such "registration" and do not follow the priority of registration or register an adequate number of ship clerks in violation of said agreement.

5. That the defendant LOCAL 34 collected compensation monthly as a "permit" to work under said collective bargaining agreement from all non-union ship clerks, both for itself and the defendant ILWU, including monthly charges itemized for "representation and caucuses" in connection with said collective bargaining agreement which said monthly permit charges were identical in amount with the dues and assessments of its full-book members.

6. Confined votes in election of said employee member of the

defendant Committee solely to the said full-book membership, including said supervisory employees and retired union members not dispatched from day to day from said hall and excludes plaintiff and all other full-time members of the ship clerk working force in the Port who are not acceptable to the union membership, from such vote.

7. Confine election of hiring hall dispatchers who actually give out jobs, to vote and election by such full-book union members, including supervisory employees and retired union members, who are not dispatched from day to day from said hiring hall, and exclude the plaintiffs and all other members of the ship clerks' full-time working force not admitted into full-book membership from such vote.

8. Exclude from all mechanics of grievance and from arbitration under the said collective bargaining agreement, all non-union non-registered ship clerks, including the plaintiffs, and when plaintiffs seek the judicial determination, discriminate even further against the plaintiffs therefore.

9. Dispatch to all jobs in preference full-book union members, who choose to work and give priority not only to dispatch but employment of said union members, including jobs with higher pay, overtime, or penalty pay.

10. Permit and assist the defendant PMA to discriminate against the non-union ship clerks, not only in such employment, but in paying non-union ship clerks and to permit PMA to profit by said discrimination:

a. Although the plaintiffs and other non-union ship clerks, members of the permanent working force do the same work under the same contract provisions, it pays plaintiff and the other non-union clerks

for actual hours, and not under the Eight-hour Rule, and no fringe benefits, though the money therefor is paid PMA by the individual employers according to the terms of the collective bargaining agreement.

b. It pays the union members according to the provisions of the agreement.

c. Non-union members, when dispatched (without said current discrimination against the plaintiffs for seeking judicial remedy) earn between $4,000 to $5,000 per year, working ordinary business days during ordinary business hours (not overtime or evenings where there is additional or higher pay) and receive no part of the vacation, welfare and pension benefits or Mechanization Fund payments. On the other hand, union members receive about $5,000 per year more, plus two weeks at straight pay, or more, as vacation pay, plus all the Welfare and Pension benefits, and some unknown 410 of the industry receive from PMA payments for the Mechanization Fund benefits, though some 1,390 more are entitled thereto, and said union members will as beneficiaries receive such of said multi-million dollar fund, as may be disbursed, unless judicial remedy therefore intervenes.

The amended complaint (R-48-50) sets forth the contraversy and how this use of registration is made coextensive with full-book union membership in LOCAL 34, and how the union collects by its monthly "permit" charges, including representation and caucuses, (the same sums monthly as it collects from its full-book members for dues and assessments); that this is used as a means to discriminate against the plaintiffs and 48% of the full-time working force dispatched from the hiring halls, and to pay them less, although PMA does collect the full contract compensation

on each employee's work, but profits by joining in this procedure to the extent it keeps the plaintiff's compensation, and the other non-union full-time members of the working force.

The defendant PMA noticed a motion. (R-56) seeking to dismiss the complaint, asking for a Summary Judgment in the form of a stay proceedings though it is specific performance of the alleged contract to arbitrate The defendant unions, defendant employee members of the COMMITTEE, and of the trusts, adopted this motion.

In support of PMA's and the employer members' Motion for Summary Judgment, PMA filed an affidavit of J. A. ROBERTSON (R-71). This affidavit for ROBERTSON states that he is secretary of the PMA, and that ILWU is the duly recognized exclusive collective bargaining representative of ship clerks. The affidavit sets forth that the ILWU-PMA collective bargaining agreement in effect prior to June 1962 contained a written agreement, in which portions were set forth hoc verba, including grievance and arbitration provisions constituting four pages of quotations of this alleged agreement, and it sets forth in substance alleged rules covering registration and re-registration of clerks in San Francisco.

The ROBERTSON affidavit (R-75) states that virtually identical complaint involving 35 other non-registered clerks similar to the plaintiffs, in ANDREWS vs. PMA, Superior Court, San Francisco, was filed on March 26, 1962, and the plaintiffs were represented by the same counsel, and that the Honorable Joseph J. Karesh stayed further proceedings in the ANDREWS case, and attaches a copy of the Order of the Superior Court dated March 28, 1963, and states that the plaintiffs never presented their

claims in the grievance and arbitration machinery provided under the collective bargaining contract. Attached to the affidavit as an exhibit is a copy of the order in the Superior Court action, stating a Motion for a Summary Judgment was made and that the Court having considered the argument of counsel and the memorandum and affidavit submitted in support and opposition to the Motion "and Richard Ernst as counsel for the employer defendants and George R. Andersen as counsel for the union defendants, having orally represented to the Court at the hearing that the collective bargaining contract contains a detailed grievance procedure including arbitration before Professor Kagel of the University of California," and that the issues presented by the complaint can be made a grievance and taken by the plaintiffs through the grievance procedure to arbitration, and the Court's attention having heretofore been directed to the records of a companion case filed in the United States District Court for the Northern District of California styled FRED A. ALEXANDER, et al., vs. PACIFIC MARITIME ASSOCIATION, et al., No. 40935, and the recent decision of the United States Court of Appeals for the Ninth Circuit in said action No. 18324 in the Court of Appeals, and based on the record and pleadings herein and the representations of counsel.

> "The court finds that there is in fact a collective bargaining agreement herein which does in fact contain a grievance procedure including ultimate arbitration before PROFESSOR KAGEL."

It should be observed that under California procedure, an order to arbitrate, is not an appealable order as it is under the Federal law and decisions. It should also be noted that although repeated requests have been made to have a determination by the arbitrator of his jurisdiction from

March 1963, for the entire balance of that calendar year, through opposition of both Ernst and Andersen, and delay by PROFESSOR KAGEL, no hearing has been had during that entire calendar year, and it was not until December, 1963, that KAGEL would even meet with counsel to discuss the procedure for hearing the issues on jurisdiction.

To this affidavit of ROBERTSON for Summary Judgment, were filed two affidavits in resistance. One was by RAY MARVIN (R-115). MARVIN'S affidavit sets forth that the collective bargaining agreement in the above entitled action is set forth in para. 5 of the amended complaint, pages 2 and 3, and consists of eleven writings and quotes the provision as to modification; that any amendment, modification, change, alteration or waive of any provision must be in writing, and that this provision has never been modified or changed. It sets forth that the alleged provision set forth in the ROBERTSON affidavit is no part of the collective bargaining agreement, but is Section 17 of the Longshore Agreement of May 1962, a separate and distinct agreement covering solely Longshoremen and not ship clerks whose collective bargaining agreement is separate and dis tinct therefrom, and that the plaintiff is entitled to a jury trial on the factual issues as to the contract and its contents, and that the ship clerk's bargaining agreement contains no provision as to the grievance or arbitration.

MARVIN'S affidavit sets forth (R-117) that the affiant on June 26, 1962 through his counsel, Mr. Crittenden, demanded in writing of the defendant ILWU, LOCAL 34, PMA, JOINT PORT CLERK LABOR RELATIONS COMMITTEE, and the defendant trustees, that if there were any mechanics or provisions as to arbitration, that he would welcome such mechanics of arbitration to solve the dispute or any phase of them. That

the defendants and each of them refused to reply to said written communication, and plaintiffs filed their action on August 13, 1962, six weeks after said communication. The affidavit sets forth that the defendants cannot refuse to arbitrate, and then ask a stay of this action required by the refusal to arbitrate. The affidavit sets forth that this action has been pending since August 13, 1962, and that no request was made to arbitrate until the Motion was noticed in May of 1963, some nine months thereafter, and if there were not already a waiver, such would be and is a waiver of any provisions for arbitration, if in fact there were any provisions of arbitration.

In opposition to the showing for Summary Judgment CRITTENDEN as attorney for the plaintiffs, filed his affidavit (R-103). He states that the collective bargaining agreement covering the ship clerks in the Port of San Francisco is the written contract set forth in the amended complaint, page 2, to wit, and lists the eleven documents starting with the Master Agreement, for April 19, 1962. The affidavitquotes the provision that the agreement cannot be amended, modified, changed, altered or waived except in writing executed by the parties, and that this provision is still in full force and effect.

MR. CRITTENDEN'S affidavit (R-104) sets forth that portions of the Section 17 set forth by the ROBERTSON affidavit are extracted from the Longshore Agreement of May 9, 1962, which by its terms applies solely to Longshoremen, and not to ship clerks, who have a separate written collective bargaining agreement. That other portions (numbered 1 and 2) appear to be part of the language of the Ship Clerk's Master Agree-

ment. It states that the quotation in ROBERTSON'S affidavit, page 5, lines 9 to 26, appears to be taken from the proceedings of the defendant Committee in 1954, that states it is not to change said Master Agreement.

Mr. Crittenden's affidavit (R-105) states that in the Fall of 1961, affiant as attorney for ROY BLISS, a ship clerk employed in the Port of San Francisco, made a demand in writing under the Landrum-Griffin Act, Section 104, to inspect the collective bargaining agreement and pursuant thereto the said BLISS inspected the said writings and looked for applicable provisions as to grievance and/or arbitration, and found none applicable to "non-registered" non-union ship clerks. The said BLISS brought the list of the writings, and this list consisted of the Master Clerk's Agreement of April 1952, and subsequent written changes substantially as listed in the amended complaint, with a few omissions therefrom. That affiant called at ERNST'S office and was shown a copy of ERNST'S letter to his clients listing the writings of the Clerk's Contract, and that ERNST'S office provided affiant with copies of the agreements that affiant did not have in his files. That affiant set forth these writings in the complaint, omitting only the portions which were regulations or proceedings of the Clerk's JOINT PORT LABOR RELATIONS COMMITTEE, as the Committee is created by the agreement, and not authorized or empowered to change, alter or amend the collective bargaining agreement.

MR. CRITTENDEN'S affidavit (R-107) states that affiant as attorney for these nine plaintiffs in this action wrote the defendants and sent copies to both Mr. Ernst and Mr. Andersen, and among other things stated:

"As in that prior action, I have examined the Joint Agreement, and can find no provision for arbitration machinery for disputes involving either matters for registration or dispatch. If you know of any such mechanics or terms in the collective bargaining agreement as to arbitration covering these matters, I would welcome the mechanics of arbitration to solve these disputes or any phase of them on behalf of my client."

The affidavit of Mr Crittenden states (R-107) that none of these defendants, or either of the counsel, responded orally or in writing to the demands, and as a result thereof, affiant as counsel for said clients on August 13, 1962 filed the above action. The affidavit states that defendants having refused to arbitrate and having subsequently required the plaintiffs to resort to the judicial remedy, cannot now be heard to ask to stay the proceedings required to be commenced for their failure to respond or arbitrate.

The affidavit (R-105) attaches and incorporates pages 20-23 of the Clerk's Master Agreement of April 4, 1952 as to arbitration, and no part thereof is applicable to any of these actions, and that the defendants may not make grievance procedure to be submitted to the defendants themselves, or require the plaintiffs to submit their cause to interested party defendants for determination or control. The affidavit (R-105) states that adversaries are not competent to pass upon their own wrongs and their own breaches of contract, nor to conduct the plaintiff's cause of action.

Mr. Crittenden's affidavit (R-105) states that in August, 1962, there arose a grievance involving an employer AMERICAN PRESIDENT LINES against a certain ROPER, a Ship Clerk and client of the affiant in another action. The defendant LOCAL 34 as exclusive bargaining agent undertook

to represent the said ROPER as a "non-registered" clerk in said matter, and in line with their planned and hostile action against all such ship clerks not holding full membership in said Local, proceeded to conspire with the employer member and permanently to bar the said ROPER from all employment as a ship clerk, although the said ROPER had years of experience, had a good clear record, and although the collective bargaining agreement did not authorize said "punishment." That affiant as attorney for ROPER immediately requested arbitration pursuant to the Master Agreement and sent letters therefor in connection with said attempted appeal to the defendant JOINT PORT COMMITTEE, to the UNION, to ERNST and ANDERSEN as counsel, and to SAM KAGEL as Area Arbitrator. That the said KAGEL as said Area Arbitrator stated in writing that the said ROPER a "non-registered" non-union clerk had no remedy of arbitration under the collective bargaining agreement, and refused ROPER said arbitration.

CRITTENDEN'S affidavit (R-105) states that in his telephone conference with Ernst involving the Roper matter during November, 1962, the said Ernst advised the affiant that provisions as to grievance and arbitration quoted to affiant in a prior letter (and similar to that, set forth in the Robertson affidavit) was orally agreed upon in substance, and that the matter had not yet been reduced to a writing, nor had the exact language thereof been agreed to by PMA and the UNION as bargaining agent.

CRITTENDEN'S affidavit (R-109) sets forth that any attempt to arbitrate is a useless act for the reason that the written collective bargaining agreement does not provide for arbitration nor for grievances of

differences involving the defendant PORT COMMITTEE in registration or dispatch of the plaintiffs, and in other matters the said defendants and KAGEL as arbitrator have refused to hear and determine such matters involving "non-registered" non-union Ship Clerks.

United States District Judge Harris considered the deposition of J. PAUL ST. SURE. This is a part of the record, as an exhibit. ST. SURE testified during the deposition, page 4 thereof, that there was an oral agreement to "codify" the Clerk's Contract, but it was not yet in writing and signed (See Appendix)

On page 6, MR. ST. SURE identified the Pacific Coast Longshore Agreement dated June 1, 1961, stated it was signed May 8, 1962, almost a year after it was dated. He testified (page 7-8) that this Longshore Agreement was in effect from June 16, 1961 to the time of its execution on May 9, 1962, even though it was not reduced to writing.

On page 8 & 9, he testified that the 30-page Master Agreement was part in effect and part was not.

Section 27 of the Master Agreement headed "Modification" states that the agreement could only be amended, modified, changed or waived by another writing was read to MR. ST. SURE, and asked if it were in effect. On the bottom of page 9, he testified that he was not sure. On page 11, he testified that a similar provision was in the Longshore Agreement under Section 22.

As in discovery proceedings, counsel for the plaintiff took all documents tendered and marked them for identification, even though it was obvious they were not applicable to Ship Clerks, or clearly not parts of the agreement.

ST. SURE testified, pages 24-25, that he was not in a position to identify all of the documents, and that the total contract included the Minutes of the Coast Committee, the Area Labor Relations Committee, the Arbitrator's Award, and that they were constantly subject to modification by day-to-day understandings, evidently the oral hip-pocket type intended to be outlawed by Section 27. Indeed, the testimony of ST. SURE was that the Employers can and do delegate through the staff of PMA, various negotiations and changes of the contracts, as for instance the Coast Labor Relations Committee, by jointly signing Minutes, interpreting, clarifying, modifying or amending the basic agreement (page 25). The testimony was even stronger that there were not only the writings, but also oral understandings in the process of being reduced to writing, and certain Minutes of two committees, but also the Port, Coast and Area Committee, who exercise the same powers. At page 27, he testified that the agreement was not a piece of paper or a document, it can be an idea that can be reduced to writing, but it also can be a general idea the parties want to do something about, but haven't agreed to the terms, and it seems to be any general idea that ILWU and PMA have for a particular rule or situation. He testified that although the parties prefer to reduce it to writing, they do not always do so, and it may be done by telephone or teletype.

The PMA-ILWU Agreement of August 25, 1960, Exhibit 18, by its very terms, undertakes to modify and interpret the existing Longshore and existing Clerk's Master Agreement by providing for registration by a 5% Rule, that if 5% of work is done by non-registered employees in a particular

port, that new registration shall be made in that particular area or port.

ST. SURE testified, page 31, that $1,500,000 consideration for the execution of the August 10, 1959 document, was paid into the Mechanization and Modernization Fund. On page 32, he testified that this was collected on a man-hour assessment basis, of all employed under the bargaining agreement, and if any of the plaintiffs were so employed at that time, it was collected on their hours of work. The witness testified on page 34-5 that the subsequent $5,000,000 per year collected during the following two years, were on a combination of tonnage and man hours, and that the man hour assessment included the labor of such of the plaintiffs as were employed during those calendar years in the Port of San Francisco.

Exhibits 44, 45 and 46 (see page 123) are reports to the Federal government by the various funds who are defendants in this suit. The report to the Federal government of the Mechanization Fund designated as "wage stabilization" showed by the report of December 3, 1962, that as of the middle of the year, only $3,149,703 had been paid or held by the Fund (page 75), and the "Longshore Vesting Benefit Fund" was an unfunded fund (page 76), which states (page 78) that only 410 were apparently receiving benefits, plus an additional 1,309 were eligible but not receiving benefits. The testimony of the witness showed that many millions of dollars were collected, and paid into the Trust Fund, but the reports by the Funds to the Federal Government, required by Acts of Congress, showed a substantially smaller sum reported.

The question on page 61 was directed to when the Pacific Coast Longshore Agreement superceded the Coast Master Agreement for Clerks

and Checkers, referred to in Section 9.11 of Exhibit 39 dated February 28, 1962. On page 62, MR. ST. SURE testified that over the past ten years, they have been negotiating for a single agreement which would cover the various classifications of work, whether Clerk, Longshoreman, Carloader, Dock Worker, or whatever. Each of these classifications had their separate agreement on a separate document, and they have all been merged in a single negotiation into a single contract, and then the witness testified:

> "The mechanical job of getting them together in one volume is still in process, but there has been the record and fact over the past at least ten years to my knowledge."

The agreement dated June 22, 1962, Exhibit 21, marked for identification at page 21, under para. XXXI entitled "Term of Agreement" states that it amends Section 20.2 of the Coast Longshore Agreement and the appropriate section of the Clerk's Master Agreement. ST. SURE recognized the Master Agreement was in existence (See quotation from page 162 of deposition in appendix).

It is interesting to note that the testimony of MR. ST. SURE, page 68-9 states that awards of arbitrators are not determinative of the matter, even though made so by the written collective bargaining agreement, but it is part of the bargaining process, and even awards of arbitration are modified, changed, and altered by mutual agreement of the PMA and UNION by subsequen' bargaining.

We can safely summariz. ST. SURE'S testimony that as late as June 22, 1962, there was in contemplation of the parties, and according to the supplement of that date, both a separate Coast Longshore Agreement

applying to Longshoremen only, and a Master Agreement for Clerks and Checkers, applicable to Ship Clerks only. There has been some type of an oral understanding, but the draft of the agreement has not been agreed upon. It has merely been drawn by PMA and sent to the UNION for their consideration. As to arbitration proceedings, there is none applicable to these plaintiffs or this action as of the date of the filing and commencing of this action.

Upon this state of the record, the District Court made its order of July 19, 1963 without any opportunity for trial of any disputed issues of fact. It is clearly an appealable order under Goodall-Stanford, Inc. vs. United Terminal Workers, 353 U.S. 550, 11 L Ed 2d 1031, 77 S Ct 920.

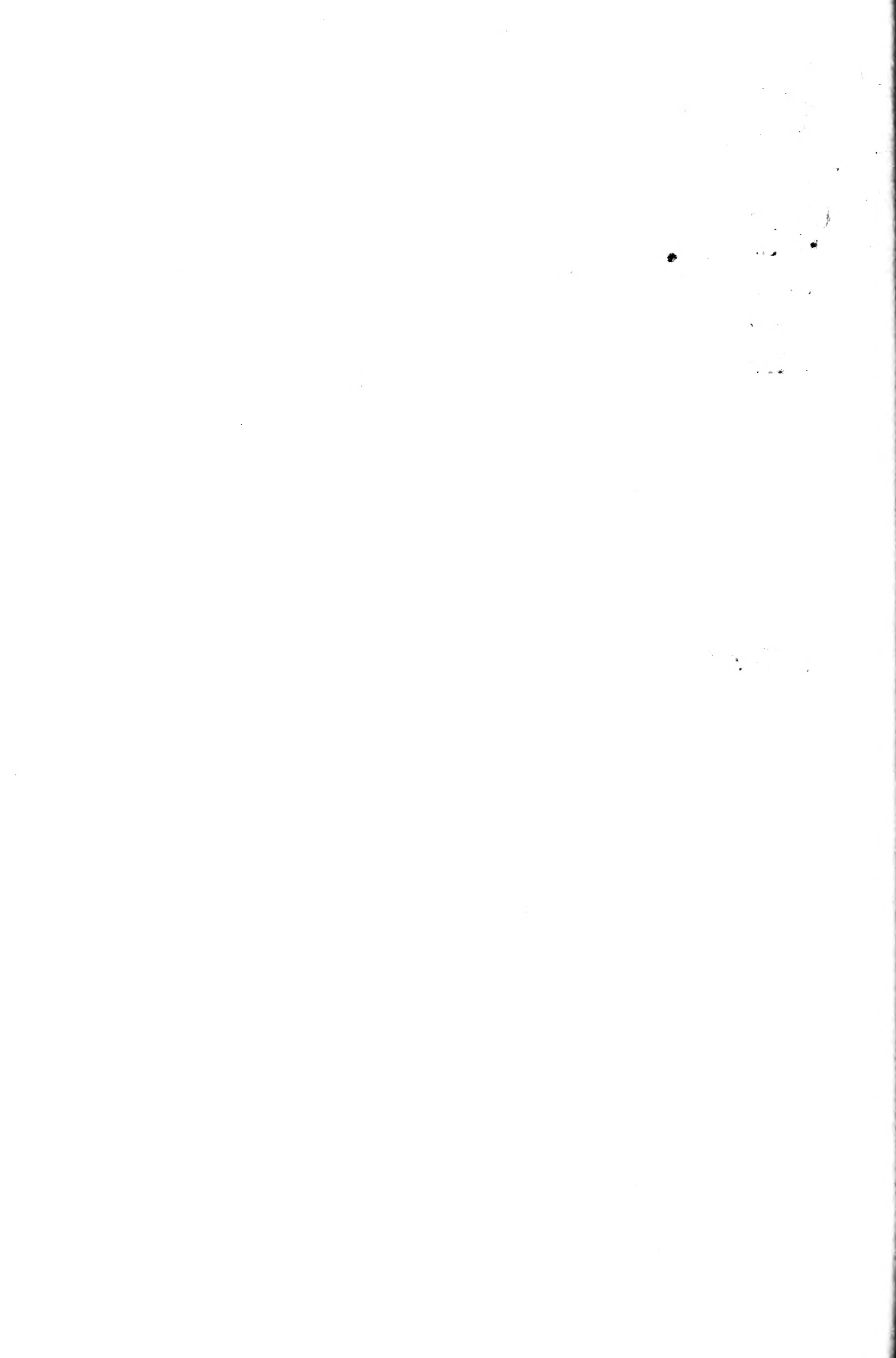
SPECIFICATION OF ERROR

1. There being an issue of fact as the existence of a written contract, and whether this contract had contractual provisions for arbitration applicable to the dispute at issue, the plaintiffs were entitled to a trial of these issues before any Judgment or Order is made requiring arbitration or stay of proceedings pending the matter on arbitration.

2. There is an issue of fact raised by the affidavits that there was a waiver of arbitration (if there were any provisions in the contract requiring arbitration) by both:

a. The passage of time between the bringing of the action in August 1962 and the defendant's Motion of May 20, 1963 for Summary Judgment, etc.

b. Plaintiffs through their counsel on June 26, 1962 requested of the defendants for arbitration of any matter in dispute, if there were any



provisions in the bargaining agreement therefor, (plaintiffs' counsel stated he could find none). Defendants refused and neglected to arbitrate or respond to this request, and required the plaintiffs to bring this action, which they did on August 13, 1962. Having by neglect and refusal to arbitrate, and thereby requiring the plaintiffs to commence this action, they cannot now contend that the action, their refusal and neglect necessitated, should be stayed. These issues of fact must be tried and cannot be resolved on affidavit. A jury trial was requested, both in the plaintiff's MARVIN'S affidavit (R-115 at 117) and in the plaintiffs' Points and Authorities (R-89 at 94).

3. Both the defendant UNION upon a demand under the <u>Landrum-Griffin Act</u>, having disclosed a contract showing there is no proceedings for arbitration, and defendant's counsel having represented to the plaintiffs and their counsel that the Master Agreement for Clerks and Checkers dated 1952, with amendments, which specifically excluded any arbitration as to the plaintiff, defendants are estopped, when the plaintiff commenced the action for breach of this contract, to contend there is another or different contract, or one having substantially different terms, including an arbitration of disputes provisions, which is not contained in the disclosed contract. This factual issue of estoppel is properly triable and not to be determined on conflicting affidavits for Summary Judgment.

4. Where there is an issue of fact as to the existence of provisions of a written contract to arbitrate, or the failure or neglect to perform such a contract or of waiver or estoppel, these issues must be tried and not resolved on conflicting affidavits.

5. The court did not make findings of fact required for its Final

Judgment, or an order which has the effect of a Final Judgment.

6. The District Court erred in refusing to enforce JUDGE SWEIGERT'S Order of May 10, 1962, overruling the objections to the interrogatories, and ordering the defendants to answer. The next step in the proceedings is one to impose sanctions when the defendant refuses to obey the order.

7. A judgment requiring arbitration is specific performance of a contract to arbitrate. The Court did not in this order appealed from specify what were the acts to arbitrate on arbitratable issues. Where there is no provision for arbitration in the written contract, shown by the plaintiffs' affidavits on the Summary Judgment Motion, it is impossible for the plaintiffs to arbitrate, as the defendants at each stage contend there is some other or different contract provisions, not in writing, making such an order on appeal meaningless, except to deny the plaintiffs all possible remedy without an opportunity for their day in Court to prove their cause of action and enforce their rights under the contract that the defendants breached. A decree of specific performance must set forth with certainty the acts which the parties are to perform under the written contract.

I. WHERE THERE IS AN ISSUE AS TO THE ALLEGED CONTRACT TO ARBITRATE A DISPUTE, OR THE DEFENSE OF WAIVER, OR ESTOPPEL IS PLEADED, THERE MUST BE A TRIAL OF ISSUES BEFORE THE COURT, AND IF A JURY TRIAL IS DEMANDED, THEN BEFORE A JURY.

In the case at bar, there were issues framed as to the existence of a written contract requiring arbitration. ROBERTSON'S affidavit (R-71)

claimed such a contract, although the testimony of the defendant's president ST. SURE was to the contrary. The defendants' affidavits, MARVIN'S affidavit (R-115) and Crittenden's affidavit (R-103) both denied the existence of any contract to arbitrate.

Affidavits of the plaintiff MARVIN (R-115) and plaintiffs' counsel CRITTENDEN (R-103) shows a timely demand for arbitration procedure, and a statement that plaintiffs' counsel could find none. Evidently, all of the defendants and their counsel, at that time believed no arbitration procedure was open to the plaintiffs, for indeed another Ship Clerk, not a plaintiff in this case, ROPER, had attempted to have arbitration for a grievance filed against him by a steamship line, and arbitration was refused because he was a non-union non-registered Ship Clerk, as were the plaintiffs in this case. Six weeks passed without so much as a reply, and the plaintiffs thereupon filed their suit. Nine months after the suit was filed, the first steps toward arbitration were commenced by this motion of the defendant PMA and the Employer defendants notice for May 20, 1963, asking for the Summary Judgment, etc., which resulted in the order appealed from.

The affidavit of MARVIN (R-117) asked for a jury trial. Plaintiffs' counsel in the Points and Authorities on Resistance to the Motion for Summary Judgment, R-93, points out that factual issues as to the existence of a contract to arbitrate is a matter of fact to be tried before a jury, and its issue appears in the affidavits.

A summary judgment to arbitrate should not be issued where there are contraverted issues of fact in conflicting affidavits.

Proctor & Gamble Independent Union vs. Proctor & Gamble Mfg. Co. 2 Cir 1962 312 Fed 2d 181.

The Proctor & Gamble Case (312 Fed 2d 181) involved a similar order as the case at bar, requiring an arbitration under a collective bargaining agreement. In that case, there was an issue as to whether the contract was in effect on the specific dates the facts of the dispute arose. The Second Circuit held that there should not be such a direction to arbitrate on conflicting affidavits and cites Fountain vs. Filson, 336 U.S. 61, 69 S Ct 574, and Preppo Corp. vs. Pressure Can Corp., 7 Cir 234 Fed 2d 700, Cert Den 352 U.S. 892. The Court points out that the duty to arbitrate is wholly contractural, and the right to arbitrate is not an incident of the employer-employee relationship, but is one based on express written contract.

The Proctor & Gamble Case (312 Fed 2d 181) is also strikingly similar in another matter, in that the Master Agreement in this case, as was the collective bargaining agreement in that case, drawn with the view of the Union on one side and the Employer's Association PMA on the other, and the grievance clause was so worded, and it does not grant the right to an individual employee any right to arbitrate. The particular agreement in this case, the Master Agreement of 1952, specifically excludes these plaintiffs by its express terms from any grievance machinery, except to go to the very defendant COMMITTEE breaching the contract to ask it to pass on its own wrong, and to condemn itself. The contract specifically excludes dispatch disputes, hi ing hall operation, pay, and any other matter from the Coast Committee or the Coast Arbitrator, except for registered

non-union Ship Clerks, of which the plaintiffs are not one, and there just are none in this Port, and no arbitration is then permitted any individual.

The present case is governed by the law applicable to labor contracts and the cases applicable to arbitration under the Federal Arbitration Act, though not binding, are guiding analogy.

Engineers Assn. vs. Sperry Gyroscope Co., 2 Cir 1957, 251 Fed 2d 133.

This distinction is clearly drawn in Goodall-Stanford, Inc. vs. U. S. Textile Workers, 353 U. S. 550, 77 S ct 920, where the Supreme Court held that Sec. 301 suits are not comparable to a suit under the Arbitration Act, but one brought under Section 301, is a different situation, and arbitration is not a step in the judicial enforcement of the claim, nor ancillary thereto, but is the full relief. The decree under Section 301 requiring arbitration of a labor dispute under a collective bargaining agreement, is a final decision within 28 USCA 1291, and appealable.

For the purpose of this analogy, let us examine the Arbitration Act cases:

L. Haas Engineering & Transportation Co. vs. American Independent Oil Co., 2 Cir 289 Fed 2d 346 Cert Den 368, U.S. 827 involved arbitration under the Federal Arbitration Act, in which it was contended there was a conditional acceptance of the contract, and the Court cannot determine on conflicting affidavits, whether this condition was or was not performed, to determine whether or not the contract for arbitration existed, but this matter must be tried as any other case, by evidence taken before the Court, or if a jury is requested, before a jury.

American Locomotive Co. vs. Gyro Process Co., CCA-Mich. 185 Fed 2d 316, holds that not only must there be under the Arbitration Act no issue as to the making of the contract and also the failure to comply to order arbitration, but there can also be a waiver of the right to arbitration, and the pleading or active participation in a lawsuit without immediately taking the steps for arbitration, is a waiver of the contract provisions as to arbitration.

Lummus vs. Commonwealth Refining Co., DC-NY 1961, 195 Fed Supp 572, involved a diversity suit applying the law of New York. It involved the issues as to whether there was a valid contract requiring an arbitration. There were numerous proceedings involving injunctions pendente lite against suits brought in Porto Rico and in the New York Courts, and it was pointed out that this was a preliminary injunction staying arbitration until the validity of the contract upon which arbitration was requested could be determined. The Lummus Case directed that the issues be tried before a Court, or if a jury be demanded, by a jury, to determine if there were a valid contract requiring arbitration, and if there were arbitrable issues.

In the case at bar, there was an issue as to whether there was a contract, and if it were in writing, if the writing required arbitration. It also raises the issue of estoppel to contend there is any other contract than the Master Agreement with the supplements pleaded in the complaint. The issues present waiver.

II. THE RIGHT TO ARBITRATE IS BASED UPON CONTRACT, AND THIS RIGHT IS NOT SELF EXECUTING, BUT CAN BE WAIVED.

Arbitration is a matter of contract, and the party cannot be required to submit to arbitration in a dispute he has not so agreed to submit

to arbitration.

United Steel Workers vs. Warrior & Gulf Nav. Co. (1960) 363 U.S. 574, 80 S Ct 1347.

Drake Bakeries Ltd. vs. American Bakeries, etc., 370 U. S. 254, 8 L Ed 2d 474, 82 S Ct 1346.

Atkinson vs. Sinclair Refining Co., 370 U.S. 238, 82 S Ct 1318.

The Drake Bakeries Case, 370 U.S. 254, directly holds that arbitration can be ordered, and a judicial proceeding stayed, only when the written collective bargaining agreement requires the controversy to be arbitrated, and the right to arbitration is not waived. In footnote 17 of the Drake's Bakery Case, the Supreme Court cites Lane Ltd. vs. Larns Bros., 2 Cir 1958, 243 Fed 2d 364 in the discussion of waiver.

The Lane Case (243 Fed 2d 364) specifically held that where a party asks arbitration, the other party is forced to abandon the demand and seek judicial relief, the defendant cannot defeat the judicial action by asking arbitration after the suit was commenced.

The Lane Case (243 Fed 2d 364) cites Radiator Specialty Co. vs. Cannon Mills, 4 Cir 1938, 97 Fed 2d 318, holding a delay of nine months (the time involved in the case at bar is August 1962 to May 1963, also nine months) after suit was filed before seeking the remedy of arbitration because of a contractual arbitration clause in the contract is a waiver of the right in the contract to arbitrate.

In the case at bar, we have a demand addressed in writing, shown in both affidavits for the plaintiff (R-115 and 103), and the refusal of each of these defendants and their counsel to communicate or to take any steps in

connection with any arbitration, or even to reply to plaintiffs' counsel's letter stating he would welcome any such mechanics, if there were any in the contracts, but that he could find none. A month and one-half later, the plaintiffs were required to file suit. If there were any applicable provisions in the collective bargaining agreement, this is certainly a waiver, and the defendants cannot now ask to stay a judicial proceeding which they required to be brought by their neglect and wrongful act.

Even after the suit was filed on August 13, 1962, no steps were taken suggesting any arbitration provisions until May of 1963, full nine months thereafter. In the meantime, there were pleadings, motions, and conduct of litigation. It makes no difference as to the merits of any grievance or matters in dispute, if the contract provides for arbitration, it must be resorted to forthwith.

United Steel Workers vs. American Mfg. Co., 363 U.S. 564, 80 S ct 1343.

If we apply the Federal Arbitration Act by analogy, to Section 301 actions, we find that the contract to arbitrate must be in writing.

Federal Arbitration Statute, 9 USCA 2.

Under California law, an agreement to submit an existing or a future controversy to arbitration must be in writing.

CCP 1281.

In the case at bar, the Master Agreement for Clerks, etc., together with the subsequent writings, are pleaded in the amended complaint (R-21-3), and that this collective bargaining agreement specifically denies all matters of arbitration and mechanics for handling grievances

in connection with registration or dispatch, and all other matters are denied and prevented the plaintiffs and each of them who are not "registered" as Ship Clerks by the said defendant Committee (R-36). See also sub-par . 8 (R-47).

The collective bargaining agreement, Ex. 2, in ST. SURE deposition, specifically provides in Section 27, that it can only be changed, modified, altered, or any provision waived, by a subsequent agreement signed by both parties. The writing can therefore only be changed by another writing.

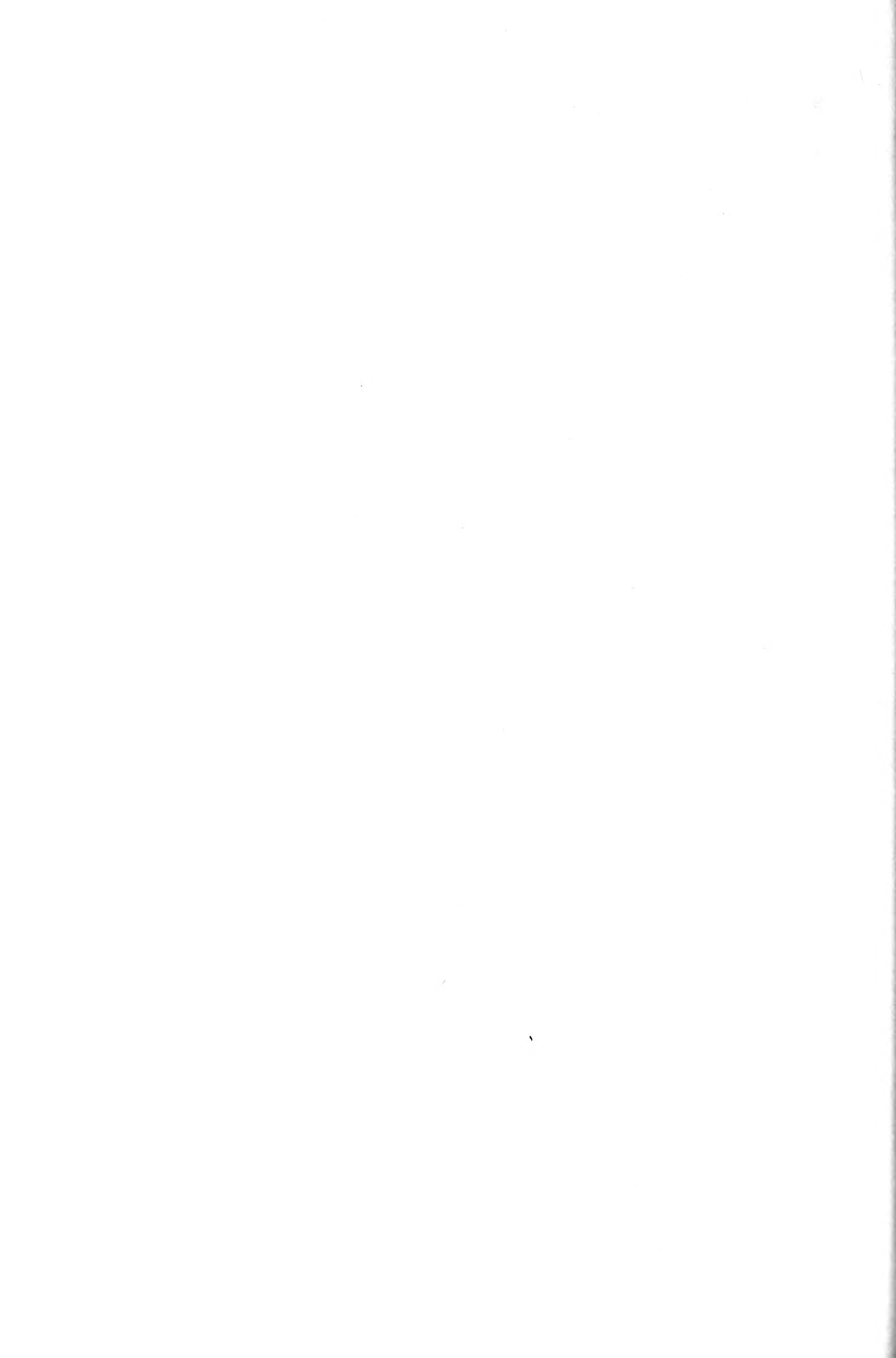
The Taft-Hartley Act contemplates that the contract will be reduced to writing, and executed as the final step in the collective bargaining process, as it makes it an unfair labor practice to refuse to do so. This provision 27 in the Master Agreement requiring all changes to be in writing, is a sufficient demand to require any change to be reduced to writing and executed.

Furthermore, the parol evidence rule prohibits any contract from being changed, modified, altered, or added to by parol evidence, except by an oral agreement fully executed on both sides, and if there is anything to be done, as for example paying an employee, the oral agreement is not fully executed on both sides.

The Landrum-Griffin Act, Section 104, 29 USCA 414, is a wholesome and necessary law permitting an employee to determine the terms of the collective bargaining agreement by inspection of the written document. This Act of Congress would be wholly defeated and meaningless, if it were proper to show an employee under this Act a written contract, and then to permit the Union or the Employer or both to contend that this is not the contract,

and that it is wholly changed and altered by parol, secret agreements, and waivers from the Unions and Employers' breaches of this contract. This Section 104 was enacted by Congress to correct a viscious practice of the Union and the Employer having secret agreements, very disadvantageous to the working man. When differences arose, the working man was faced with these secret agreements. The purpose of Congress was to permit the employee to learn the full terms of the collective bargaining agreement, under which he was employed. To permit secret oral understandings or modifications as contended by the defendants and shown in the ST. SURE deposition, is to make the Act of Congress meaningless, and to defeat its very purpose.

There is also an estoppel against the defendants contending the contract is other than that disclosed by the writings. Inquiry was made both under the Landrum-Griffin Act, Section 104, and through plaintiffs' counsel. Defendants are not now in a position to contend the written contracts they disclosed, and the plaintiffs acted upon is different, and that there is some other and different, oral, secret agreement. When any plaintiff accepts dispatch, the terms of the collective bargaining agreement is incorporated and implied into the master-servant relationship. It is the known and disclosed written contract that is part of this employment, and the defendant UNION and the defendant PMA are estopped to contend it is different, or that the contract is not as it was acted upon, particularly the disclosed terms of compensation, including deferred contingent compensation (fringe benefits), for both the individual employer and the plaintiffs believed this applied, and PMA was paid by the individual employers



upon this disclosed contract. The difficulty arises that PMA has not paid out the monies it received from the individual employers of the plaintiffs, but has fattened its pocket by retaining the difference.

Some of the monies were paid by PMA for the Health and Welfare Fund to the defendant trustees of that fund, but these defendant trustees use it solely for the full-book members of defendant LOCAL 34, and not for all employees in contravention of the express terms of the contract, until late February, 1962, when the contract was amended retroactively to June, 1961. The last document pleaded by the plaintiffs as part of the collective bargaining agreement, the Memorandum of February 22, 1962, approximately a month and one-half before this suit was commenced, leaves no doubt that this Master Agreement, Exhibit 2, in the deposition, was in full force and effect on that date. Even MR. ST. SURE'S testimony so shows (deposition, page 162). The June 22, 1962 Memorandum of Agreement, is Exhibit 21 (of the ST. SURE deposition) and par. XXXI, on page 21 of that document, states:

> "Amend Section 20.2 of the Coast Longshore Agreement and the appropriate Section of the Clerk's Master Agreement to read as follows:"

Therefore, in contemplation of the parties on June 22, 1962, when this Memorandum was executed, there was in full force and effect the Clerk's Master Agreement.

The defendant PMA and the other defendants, having been caught with their hand in the cookie jar, and realizing that this involves very substantial sums of money unpaid to the plaintiffs and others similarly situated, have undertaken to amend the facts and contend there is a secret oral under-

standing over an indefinite period changing, modifying and creating the collective bargaining agreement and completely obliterating from the agreement the solemn written contracts, including the Master Agreement for Clerks of April 1952, and all subsequent modifications thereof in writing (even as late as June 22, 1962).

Parties are not required to arbitrate matters they have not contracted to submit to arbitration, and when the factual matters in dispute as to what the contract is, has been determined upon by trial, the question as to what disputes are arbitrable, is a question of contract interpretation by the Court.

Drake Bakery, Inc. vs. Local 50, 370 U.S. 254, 82 S Ct 1348.

Atkinson vs. Sinclair Refining Co., 370 U.S. 238, 82 S Ct 1318.

United Steel Workers vs. Warrior & Gulf Nav. Co., 363 U.S. 574, 80 S Ct 1347.

A very interesting case involving a collective bargaining agreement Section 301 suit is Refinery Employees Union vs. Continental Co., 5 Cir 1959, 268 Fed 2d 447, in which the Court stated that it has the duty and authority to determine the arbitrability and its scope under the collective bargaining agreement, and also whether it was the intention, as expressed in the contract, to submit to arbitration determination of remedy for breach of the contract, including authority to award damages for miss-assigning overtime, contrary to the management's policy to pay for only work performed. There appears to have been overtime assigned by the company to employees, in violation of the collective bargaining agreement, which was acknowledged by the company. The Union sought to impose penalty and for

damages, and sought to have this arbitrated without limit as to issues. The Refinery Employees' Union Case, 268 Fed 2d 447 held that the Court was committed to broad liberalities on arbitration issues in Labor Management matters, but this policy does not permit the Court to find an agreement where there is none. As in the case at bar, it authorized arbitration of differences relating to the interpretation of the contract; however, the Refinery Case involved a contract that extended to arbitration of matters of performance, but the contract was silent as to remedy for miss-assigned overtime or breach of the contract, and the real dispute was whether the company must pay for time not worked. The decision directly holds that there is no intention to clothe the arbitrator with power to fix value or damages, and this cannot be conferred upon an arbitrator, unless the power is in the contract. It cites the following cases:

United Electric etc. Workers vs. Miller Metal Products, 4 Cir, 215 Fed 2d 211;

International Union vs. Colonial Hardwood Floor Co., 4 Cir, 168 Fed 2d 33;

Council of Western Elec. etc. Employees vs. Western Electric, 2 Cir 238 Fed 2d 892;

Local 149 vs. General Elec., 1 Cir, 250 Fed 2d 922.

All of these cases were cited for authority that without specific authorization, the arbitrator cannot award damages or impose a monetary penalty.

In the Master Agreement for Clerks, Exhibit 2, in the deposition, at pages 20 to 23, there is a Section 21 headed "Grievance Machinery"

that defines the arbitrator's authority under that contract. Pages 20 to 23 are also attached to CRITTENDEN'S affidavit (R-114). On page 23, sub-paragraph 8, the authority and the jurisdiction of the arbitrators are spelled out (when they have any authority or jurisdiction of any dispute under the contract). It states:

> "Power of arbitrators shall be limited strictly to application and interpretation of the agreement as written."

This precludes the arbitrator from determing what portions of the agreement are illegal.

It then states that subject to the limitations contained in Sec. 21, the Coast Arbitrator shall have jurisdiction to decide any and all disputes arising under the agreement, including cases dealing with resumption or continuation of work. Sec. 7 on page 22 specifically directs that neither the Coast Arbitrator nor the Coast Committee shall have any power concerning the methods of maintaining registered lists, or the operation of hiring halls, or the interpretation of Port working and dispatch rules, or the interpretation or enforcement of the contract provisions relative to continuance of work pending determination of disputes, or discharges, or pay. It should be noted that the case at bar turns upon everything excluded. It should be noted that at the bottom of paragraph 7 there is a provision that nothing in that paragraph shall prevent an individual non-union non-registered clerk claiming discrimination from exercising his option to have it adjudicated by the Coast Committee. This exception does not apply to arbitrators.

Section 21, sub-para. 8 on pg. 23 of that document states that the arbitrator's decision must be based upon the showing of facts under the

specific provisions of the written agreement, and expressly confined thereto.

There is no specific grant of power to impose penalties or to grant damages, or to impose a trust, and there is a specific prohibition against the Coast Arbitrator passing upon any matters of registration, dispatch, operation of a hiring hall, or pay, and other matters enumerated.

As in the Proctor & Gamble Independent Union vs. Proctor & Gamble Mfg. Co., 2 Cir 312 Fed 2d 181, we have in the case at bar a collective bargaining agreement which envisions the usual arbitration dispute between the union on one side, and the employer on the other. The plaintiffs are non-union ship clerks who are the subject of the hostile and planned discrimination of the union, and must in this action join both PMA and the UNION, together with the Committee consisting of a member of each, who conducts the hiring hall and maintains the registration lists, from which so much of the matters involved in this suit flow. The major party guilty of the actual acts in connection with the registration is of course the defendant COMMITTEE who runs the hiring hall, and maintains these registration lists. Relief is only effective as to registration and dispatch when the Committee is a defendant.

The Section 21 provides for the appointment of a Port Committee in each Port, and a Coast Committee. An Area Committee referred to in the deposition exists only under the Longshore Agreement. There are none for the Clerks. Were the Longshore Agreement now the Clerk's Agreement, as urged by the defendants, there would be an Area Committee. Section 21 provides that the Employer and the Union shall each have one vote. Para. 2 provides that the arbitrators shall be paid by the parties, meaning

the Union and the Employer. This is strengthened by sub-par 6 at the bottom of page 21 providing that non-union registered clerks who present a grievance shall pay the Union its costs of participation, adjudication, and any arbitration of his grievance. The non-union registered Ship Clerk does not pay directly showing that arbitration and the provisions as to expenses envision the Union on one side, and the Employers on the other. Sub-par. 3 on page 21 provides how grievances arising on the job shall be processed in the following manner:

When a matter such as we have here, involves the Committee's registration list and dispatch, there is an unusual situation of the only party having contractual power to adjudicate disputes being the guilty party who has violated the contract. This is so foreign to any concept of justice and fair play, and requires such a strained construction of the writing, as to show that it was not intended to apply to any dispute involving the COMMITTEE, consisting of both the defendant Union and the defendant PMA.

Sub-par. 4 of Sec. 21 specifically provides that the Area Arbitrator only hears matters in which the COMMITTEE is unable to act by reason of a failure to agree. In practice, the UNION refuses to vote against its full-book members, and there the matter sits, unless it is referred to arbitration. This does not happen when we have a non-union non-registered Ship Clerk, against whom the UNION has its planned and hostile course of conduct and discrimination.

Sub-par. 5 provides that a failure of either party to participate in any step shall automatically move the matter to the next higher level. Sub-par. 6 provides that an individual non-union registered Clerk as an individual may use the grievance machinery, but that he shall pay the UNION the costs of its participation and any arbitration costs. There are just no

non-union registered Clerks in this Port. It is certainly not applicable to any of the plaintiffs whom the defendant COMMITTEE refuses to register in violation of the contract. The arbitration is only applicable if the defendant COMMITTEE is unable to agree.

Sub-par. 7 of Sec. 21 provides that the decision of an Area Arbitrator claimed to be in conflict with the agreement shall be immediately referred to the Coast Committee, which also consists of the two defendants, the UNION and PMA. One would hardly expect a fair hearing or justice in the hands of one's adversaries. Only in the event both the Union member and the Employer member of the Coast Committee are unable to agree, may the matter go to the Coast Arbitrator. This happens when it involves a full-book member of the UNION where the UNION uniformly takes the position its members can do no wrong. It is then spelled out in Sec. 7 that neither the Coast Committee nor the Coast Arbitrator have any power to review any decisions as to the registration or dispatch or operation of the hiring halls or pay, etc. At the last of Sub-par. 7 and the last of Sub.-par. 6, there is a provision which creates an ambiguity. Sub-par. 6 provides for remedies, evidently at the local level, to be adjudicated as to individual non-union registered clerks. Sub-par. 7 provides that only non-union registered clerks claiming discrimination by the Union because of non-membership in the Union may then take such matter to the Joint Coast Committee, without any reference or power to go to any arbitrator. Here again, such a party is relegated to a hearing before his adversaries and not before an impartial third party, nor even an arbitrator selected by his opponents.

From the foregoing, it can be seen that there is no provision as to

arbitration, and that such provisions as to arbitration, specifically exclude these plaintiffs. By requiring one to submit one's grievances to one's adversaries sitting on the defendant COMMITTEE who conducts the hiring halls, makes registration, and who breached the contract, is no remedy at all.

III. A PARTY IS NOT REQUIRED TO SUBMIT HIS MATTERS FOR DECISION TO HIS ADVERSARIES.

It is a basic concept of fair play that a person have some semblance of justice and some tribunal somewhere to try these disputes. As we have shown, the contract provides for no remedy for these plaintiffs, except to go to the defendant Port COMMITTEE who violated the contract, and ask this COMMITTEE consisting of the defendant UNION representative and the defendant PMA employer representative directed, to admit it erred and had acted with discrimination and in violation of the contract.

A similar situation arose and was urged in Steele vs. Louisville & N. R. Co. (1944) 323 U.S. 192, 65 S Ct 192, where it was urged that the employees had an administrative remedy before a Board, under the Railroad Adjustment Act, consisting of members chosen by both the employer and the union. The Supreme Court held that this was no remedy because of the planned, purposeful discrimination by the Union.

In Edwards vs. Capital Airlines, (Ct of App-DC 1949) 176 Fed 2d 754, Cert. den. 338 U.S. 885, certain pilot plaintiffs brought an action after an adverse ruling before a Board under the airline act, consisting of two employer and two Association (union) members. The Court pointed out that the grievance as to seniority, though nominally against the employer company, was against the other employees, and the company was a mere by-

stander, and the union could have taken a neutral position, but it did not, and took a position adverse to the appellants. The Edwards Case, 176 Fed 2d 756 points out that where there is a conflict of interest, a party does not have to submit his disputes for a decision to his adversaries, and that Congress did not intend to submerge the minority's interests in the grievance machinery it provided, and the employee had a right to have his grievance heard by more than merely the union and the employer, for Congress anticipated and contemplated an effective participation. The Edwards Case, 176 Fed 2d 754, held that although there was normally a presumption of validity to the acts of such a Board provided by Act of Congress, yet it was subject to potential extremely dangerous situations that would affect the rights of the minority non-members, and the Court removed the doctrine of finality. This Case, Edwards vs. Capital Airlines, 176 Fed 2d 754, is particularly applicable here for any grievance machinery which relegates the employees to the hands of their adversaries, and requires the very entity conducting the hiring halls and making the registrations to denounce themselves and their own actions is a very strong showing, and further the Edwards Case would prevent any arbitration being final, where the UNION who took a hostile position against the plaintiffs had any part in the selection of the arbitrator. In the case at bar, Sec. 21, provides for the naming of the arbitrator by the UNION and PMA, both defendants. This is hardly one's idea of a fair arbitration to go before an arbitrator who holds his appointment from the two defendants, and expect an arbitrator to take a lucrative job in his hands, in ruling adverse to those who appoint him.

A case by analogy is that of Elgin J.E.R. Co. vs. Burley (1945)

325 U.S. 711, 65 S Ct 1296, where a union as collective bargaining agent settled a monetary claim for penalty wages aggregating $65,274.00 involved under the Railroad Adjustment Board. The Court at page 733, points out that a collective bargaining agent has authority to represent an employee in disputes before the Board, but that in any matter involving settlement, the employee has a voice in it, and Congress did not intend to submerge wholly the individual, and the minority interest, and nullify the rights of employees. At page 736 of 325 U.S., the Court held that the Act of Congress gives more than the mere right to be heard by a union and a carrier in two alternate situations, the first is where the union in its action would do more than remotely affect the other employees, or in the alternative situation where the interest of the employee involved, is not a member of the union, or the interests are not opposed to collective interests of a large number of employees represented by the union, or the union is hostile. The Elgin Case holds that the union as the collective bargaining agent can act under the collective bargaining agreement as to future distribution of work, but not as to settlement of matters for penalty wages or things in the past.

IV. THE INSTANT ACTION INVOLVES A BARGAINING AGREEMENT, ILLEGAL AND VOID AS TO PART.

The registration provisions of the collective bargaining agreement in effect on June 1, 1951, and prior thereto, granted preference of registration to Union membership. For this reason, the contract was determined to be illegal and void for these terms in 90 NLRB 1021 and 98 NLRB 284, and by this Court, in its decision in 211 Fed 2d 946. This seemingly innocent seniority date of 1 June 1951 is blanketed in and carried over into the

present contract, as it grants preference of employment and dispatch to those who were registered under that illegal agreement on June 1, 1951. Not only is the employee sent to the job in preference, if he were so registered on that date, but if there is work for only one employee, the one having that seemingly innocent seniority date must continue on the job, and the others be released. If at a pier, one clerk is required for overtime, it must be that man having that seemingly innocent seniority date. The man with this seemingly innocent seniority date gets the pick of all available over all others when dispatches are made each day.

In addition to this, the Master Agreement, Ex. 2 in the deposition specifically provides that registration can only be made with "mutual consent" of the employee representative and of the employer representative, both of whom act at the direction of their respective principal. Both must act together to register a man. The union then need only withhold its consent, and grant it as it does only to full-book members of LOCAL 34. As a result, all those having any status of registration in the Port of San Francisco as Ship Clerks are union members, holding full-book membership in defendant LOCAL 34.

Similar provisions granting a union this type of control, have been held illegal and void. In Phoenix Tinware Co., Inc. (1952) 100 NLRB 528, the master contract provided that no tinsmith, welder, etc., should be employed, unless "recognized by the union." The Board held that since "recognition" by the union was not defined in the contract, and gave the union a "veto" on employment of any employee, this provision of the contract was invalid, and therefore the Board could hold an election for

want of a valid bargaining agreement. The Phoenix Case, 100 NLRB 528, turns on and follows Newton Investigation Bureau (1951) 93 NLRB 157, also a question of whether there should be an employee election held. The collective bargaining agreement provided that the employer could fill vacancies or create new positions, and choose his own employees "however, such persons employed are satisfactory to both parties to this agreement." No limit was placed on the ground of the union's discretion. The Board held that this contract provision as to requiring the union approval for hiring was beyond the intent of the union security provisions of Section 8 (a) (3) of the Act.

The arbitrator, by specific provision of Sec. 21 of Ex. 2 (deposition), Master Agreement for Clerks etc., has his authority limited to application and interpretation of the agreement as written, would not and could not under this agreement determine the nature and extent of the illegality. Actually, the arbitrator could not consider the oral parts of the contract which the defendants contend is much of the collective bargaining agreement, for want of having agreed upon and executed the wording of a "codification" of their numerous oral agreements, understandings and other matter they contend are a part of the agreement. See Posner vs. Grunwald-Marx, Inc. 56 Cal 2d 168, 363 Pac 2d eee, 14 Cal Rptr 296, for an able discussion by Justice Peters of such a provision in a collective bargaining agreement restricting the consideration of practices and "industrial common law" by the arbitrator.

V. THE PLAINTIFFS SHOULD HAVE BEEN PERMITTED FULL AND COMPLETE ANSWERS TO THEIR INTERROGATORIES.

The plaintiffs sought by their interrogatories to elicit the

defendants' contentions as to the contract, and a mass of information on which oral depositions and discovery of documents and writings could be made. JUDGE SWEIGERT by his Order of May 10, 1963 (R-84) held these proper interrogatories and ordered them answered. A substantial part of the plaintiffs' case must, of course, be determined upon discovery, the doors of which are not open to those in arbitration. Indeed, under the equitable bill of discovery, before the Federal Rules, much of this information would be available to the plaintiffs. The defendants have throughout used every means to avoid discovery. After the Order was made, the Order was flagrantly violated by the defendants, there is no other recourse or remedy for the plaintiff than to ask sanctions. The Order appealed from denies the plaintiffs any further steps in their discovery.

Certainly, the portions of the action permitting the plaintiffs to obtain the information requested on the interrogatories and necessary by discovery, should not be denied them, least of all should the plaintiffs be denied any remedy which would make arbitration a mere empty gesture.

CONCLUSIONS

1. The written collective bargaining agreement denies all effective remedy for any grievance, and prohibits arbitration for the plaintiffs.

2. The issue as to the collective bargaining agreement, and whether it contains any provision as to arbitration as contended by the defendants in their affidavit of ROBERTSON, or as denied by the plaintiffs' affidavits of MARVIN and CRITTENDEN, is an issue which must be tried. It is not to be determined by summary judgment on conflicting affidavits.

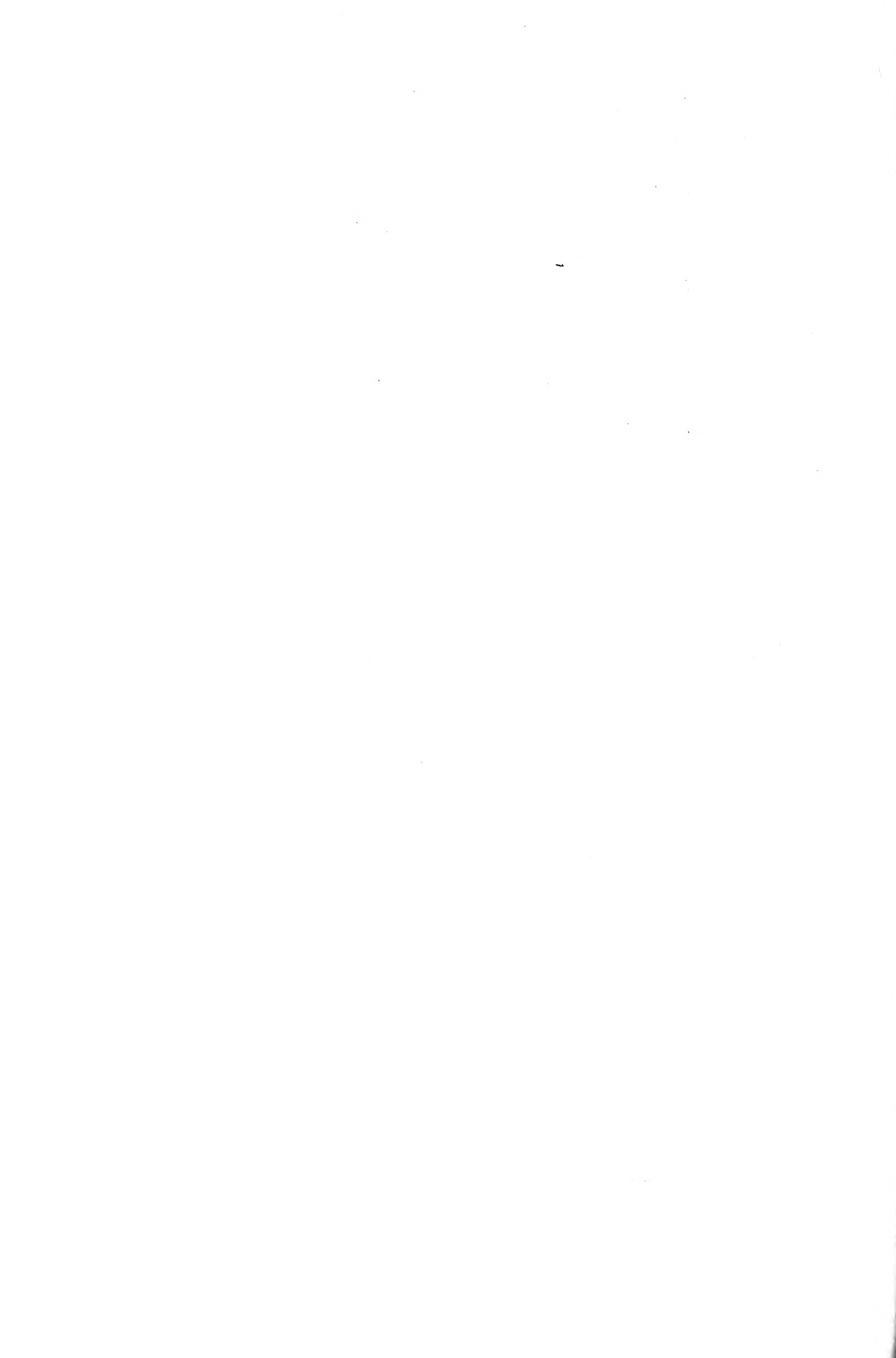
3. The factual question of waiver and the estoppel to raise any

contention of any other contract than the Master Agreement and its supplements as alleged in the complaint, is one that must be tried, not determined on summary judgment.

4. The Court merely stayed proceedings, without setting forth the specific steps of the alleged agreement to arbitrate. Any steps the plaintiffs may see fit to take in this arbitration, must be by hearsay, and the defendants can and will contend at every turn that they have a secret understanding for some other procedure. Any specific performance decree, judgment or order must set out specifically the acts to be done. That is wholly lacking in this Order appealed from.

5. A summary judgment cannot be entered upon conflicting affidavits, but the issues of fact must be tried as any issues of fact are tried by the Court, particularly a legal action under Section 301 for breach of a collective bargaining contract.

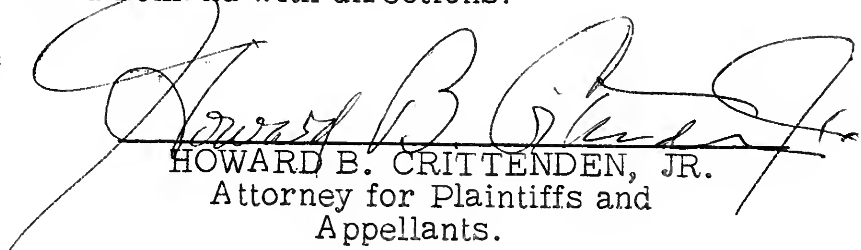
6. There is no claim of any collective bargaining agreement authorizing any arbitrator the power and authority for the awarding of damages, the imposition of a trust, the declaratory relief sought, nor discovery sought. Such provisions as there are as to arbitration, is clearly not applicable to the plaintiffs, but only as to the Union on one side, and PMA on the other, or in limited instances to non-union registered Ship Clerks. The specific contract prohibits any arbitrator from determining either the alleged oral agreements, confining his determination solely to the contract as written. This precludes any arbitrator's determination of the illegal provisions, including the parts of the agreement in contravention of the Federal Act applicable to such jointly trusteed funds.



7. The plaintiffs are entitled to their discovery, and to enforce the Order of JUDGE SWEIGERT of May 10, 1963, ordering the defendant PMA to answer the interrogatories submitted.

We ask a reversal and remand with directions.

January 17, 1964



HOWARD B. CRITTENDEN, JR.
Attorney for Plaintiffs and Appellants.

APPENDEX

ST. SURE testified during the deposition, page 4 thereof, that there was an oral agreement to codify the Clerk's Contract, as follows:

"Q. And what is your connection with the defendant PMA?

A. I am the president.

Q. Are you familiar with the Collective Bargaining Agreement applicable to the Ship Clerks in the Port of San Francisco?

A. I am.

Q. Now in this recent application for Class B Registrations of Clerks, I notice the term "Pacific Coast Longshore and Clerks Agreement." Would you tell me what that document is?

A. Well, the document now in printed form is a Longshore agreement which covers working conditions and other provisions governing the Longshore employment in Pacific Coast Ports. It also includes a supplement which is in the process of preparation covering the pay and working conditions of marine clerks; it also includes a number of Joint Coast Labor Relations Committee rulings, findings and agreements, and it includes a variety of arbitrator's awards. It is not a single document in the sense of a specific piece of paper.

Q. Now as to the points covering specifically Ship Clerks in the Port of San Francisco, that is in the course of preparation, is that correct?

A. Yes, sir.

Q. How far has it reached? Has it been typed yet?

A. I think the first draft has just been prepared. I say, "in the course of preparation." This is an endeavor to codify as well as we can in the agreement everything including the codification of early agreements, understandings, rulings and awards that I have mentioned. I think the status of it is that we have prepared a first draft of this codification or draft of the agreement, and this has been sent to the International Union for their observation or review, and there will be further discussion as to whether or not the language actually describes the agreement that we have reached in the past and currently are in effect. When that is completed, it will be printed up, as was the recent publication of the so-called Longshore portion of the agreement within the last few months, after some ten years of attempted codification of the changes that had taken place."

ST. SURE recognized the Master Agreement was in existence. Page 162 of the report of the deposition transcript contains the following:

"Q. So in June of 1962 there were in contemplation of the parties two sets of documents, one known as the Longshore Agreement, and the other known as the Clerk's Master Agreement.

A. There were in effect two pieces, or a combination of separate pieces of paper which have been referred to as the Coast Master Agreement for Clerks and Coast Agreement for Longshoremen. These documents have been merged in a single agreement covering both classifications of work.

Q. But I am referring to the date of this Exhibit 21, which was June of 1962. At that time, there were the two agreements, weren't there?

A. That's right. There were two documents which I indicated, with a historical background that I have referred to, and with the changes subsequently made to combine them into a single document which is still in process."

Exhibit 25, of this deposition, are Minutes of the defendant Clerk Committee of San Francisco. On the third page of that document, entitled "Memorandum", it specifically states:

"The parties acknowledge that the rules herein contained are intended by them to be in conformity and consistent with the provisions of the Master Agreement for Clerks and Checkers and Related Classification, and they do not intend hereby to change any of the provisions of said Master Agreement."

Exhibit 25 on page 1 states:

"Union submitted a list of 108 men for Employers' consideration. The list contains 56 men for the said San Francisco Dispatch Hall, 52 men for the East Bay Hall.

Employers, in considering the list, requested the Union an additional 17 men to make a total of 125, since the industry could well absorb the higher figure based on hours of work performed by both registered and social security over a period of one year.

Union felt that its membership at this time, was not prepared to accept a higher figure, and requested the Employer to give consideration to the present submitted list, with discussion of additional men to take place at an earlier date."

In the course of the ST. SURE deposition, the question turned to the arbitration. On page 115:

"Q. Now, suppose I ask you this? If a man had a -- we'll say a belief that he hadn't been registered, because he was discriminated against by the Union or because of non-union membership, he would take the grievance then to the same Committee, the Joint Port Labor Relations Committee, that did this act. Is that correct?

MR. ANDERSEN: You're assuming that something is being done --

MR. CRITTENDEN: I'm just trying to find out what the procedure is that Mr. St. Sure is describing to me.

WITNESS: Well, the procedure is described in the Contract, and I think that is the thing that controls.

MR. CRITTENDEN: Q. Well, Suppose a man were discriminated against by the Committee because of non-union status that he had, he would have to take it to the same group that had done this act, is that right?

MR. ERNST: Mr. Crittenden, the Contract is very clear on these things. What you say is right, but you are now asking all sorts of hypothetical questions."

On page 162 of the deposition:

Q. Now we will refer to Exhibit 2, Plaintiffs' Exhibit 2, which is the Master Agreement for Clerks and Checkers dated April 4, 1952, and refer to the grievance machinery on page 21. Now assume that there were a grievance, that for instance, Mr. Alexander, who is one of my clients in this matter, had and he wished to present. He would, I take it, in the first instance -- for instance, he claims he is registered. He would have to go to the Port Committee, wouldn't he? The Clerks Joint Port Labor Relations Committee, a defendant in this suit, isn't that the one he'd go to?

A. Yes, sir.

Q. And only in the event the employer member and the employee member disagreed, would he have the right to go to the next level?

MR. ERNST: Now you are speaking of 1952, Mr. Crittenden.

MR. CRITTENDEN: I'm talking of that document.

WITNESS: As of this document. That is correct.

MR. CRITTENDEN: Yes.

Q. And the power of the Coast Committee, I take it, on page 22, and the Coast Arbitrator, excludes anything to do with registration or dispatch, doesn't it? With the exception of the bottom paragraph which we will come to.

A. That's what it says there. I accept that, yes, sir.

Q. Now, at the bottom of the page, the only exception in there applies to registered and non union clerks, doesn't it?

A. That's what it says here, yes, sir.

Q. So a non-registered, non-union clerk is not within that clause for any exception

MR. ERNST: You're referring to the clause that takes him to the Coast Labor Relations Committee?

MR. CRITTENDEN: Yes, I'm trying to find out. He would not go anywhere above the Joint Port Labor Relations Committee unless one, either the employer or the employee representative disagrees.

MR. ERNST: Well, you seem to skip the local arbitrator, is that it?

MR. CRITTENDEN: Well, now, that's the point we're coming to.

Q. You can only go to the port or local arbitrator in the event there is a disagreement between both the employer and the employee members, isn't that correct?

A. I think that's what the language says.

Q. Yes. Do you know of any other language in any other provision of the Clerk's Agreement in effect up to the time of the filing of this action in the middle of 1962 that permitted any other procedure?

A. I don't know. I'd have to check back the documents as to what amendments were made. There were several amendments made to expand and provide for a procedure for the hearing of any claims of discrimination.

A. Now, on the last day of January 1963, some seven months or six months after this current suit was filed, the defendant union and the defendant PMA got together and made their agreement that we call Exhibit 20 for identification, is that correct?

MR. ERNST: I think you are not accurately stating the facts

MR. CRITTENDEN: Well, let's see if I can get the correct facts.

Q. How soon was it after our suit was filed before that was enacted?

MR. ERNST: That we can determine from the record.

MR. CRITTENDEN: Q. About six months?

A. Well, this document is dated January 31, 1963. I have already testified to that. A comparison of that date and the date of your suit would give you your answer, I guess.

Q. Did the union suggest this supplement of January 31, 1963, marked Plaintiffs' Exhibit 20?

A. I am not sure whether they did or we did. It was a matter of joint negotiation or agreement.

Q. Do you know who negotiated that?

A. Well, I was in on it.

Q. Well, when did you start negotiations?

A. I couldn't tell you.

Q. Could it have had anything to do with this pending litigation?

A. I don't know.

Q. Could that have been initiated in that way?

A. I don't know that it did. It may have had some bearing."

No. 18913

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

FRED A. ALEXANDER, LOUIS P. CAMAROTA, GEORGE CATHRO, ALBERT S. DIMOND, LEWIS FREEMAN, RANK MARANI, RAY C. MARVIN, JAMES NEWELL and EARL D. PETERSEN,

Appellants,

-vs-

PACIFIC MARITIME ASSOCIATION, a non-profit corporation; INTERNATIONAL LONGSHOREMEN'S & WAREHOUSEMEN'S UNION, an unincorporated association; SHIP CLERKS ASSOCIATION, LOCAL 34, ILWU, an unincorporated association; JOINT CLERKS LABOR RELATIONS COMMITTEE, SAN FRANCISCO, an unincorporated association; H. J. BODINE, L. B. THOMAS, WILLIAM CHESTER, K. F. SAYSETTE, J. A. ROBERTSON and HUBERT BROWN as Trustees of ILWU-PMA WELFARE & PENSION FUNDS: HARRY BRIDGES, H. J. BODINE, L. B. THOMAS, K. F. SAYSETTE, R. J. PFEIFFER, and CAPT. C. PRYOR as Trustees of ILWU-PMA MECHANIZATION FUND: DOES ONE thru TWENTY,

Appellees./

On Appeal from the United States District Court
for the Northern District of California
Southern Division

APPELLANTS' REPLY BRIEF

HOWARD B. CRITTENDEN, JR.
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EXbrook 7-5288

Attorney for Appellants

FILED

MAR 30 1964

FRANK H. SCHMID, CLERK

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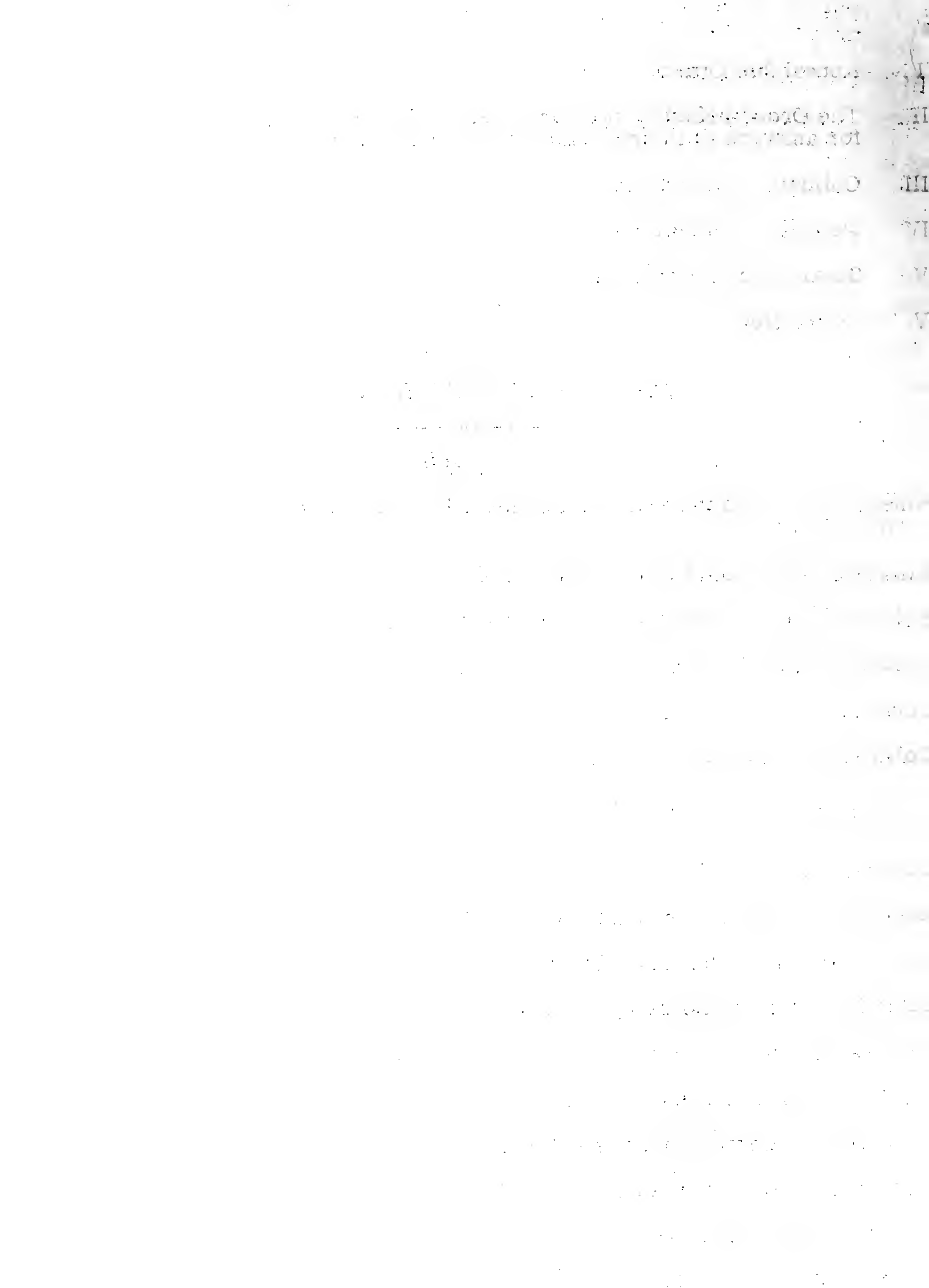

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APPELLANTS' REPLY BRIEF

The action on appeal is one at law for enforcing of and for violations of the written collective bargaining agreement, under Section 301. The appeal (R-183) is taken from the order of the District Court of July 19, 1963. The Statement of Facts appears in the Appellants' Opening Brief, and need not be repeated.

APPEALABLE ORDER

Appellees' Brief contends that the order on appeal is not appealable. The order stays the plaintiffs' legal action brought under Section 301 pending arbitration, without specifying what acts the parties may take. It is a decree of specific performance of a claimed contract to arbitrate. It leaves the plaintiffs with a choice of abandoning or losing their legal rights and remedies or to undertake arbitration pursuant to some unknown, undefined, nebulous and changing provision before their adversaries who are to judge their own acts and their own conduct.

Appellees' Brief makes no reference to 28 USCA 1292 (1) nor to the Ninth Circuit Decision of Ross v. Century Fox Film Company, 236 Fed. 2d 632, and proceeds to argue that the Appellees' motion, which was granted, is not in effect a cross bill or request for relief similar to the order in Goodall-Sanford, Inc. v. United Textile Workers 353 US 550. That case held that arbitration sought by a party to a collective bargaining agreement and an order thereon is appealable.

Appellees' Brief attempts to claim that this Court's decision of Hudson Lumber Co. v. U. S. Plywood 181 Fed. 2d 929, arising under the Federal Arbitration Act, was reversed by other cases involving other rules of law that did not even mention the Hudson decision.

Shanferoke Coal and Supply Corp. v. Westchester Serv. Corp. 293 U.S. 449, 55 S. Ct. 313 (decided the same day as the Enelow v. N.Y. Life Ins. Co. 293 U. S. 379) held that denying a stay to the equitable defense of arbitration by contract was in effect denying an interlocutory injunction, and appealable. To the same effect is the decision of Donahue v. Sequehanna Colleries Co. 3 Cir. '43, 138 Fed. 2d 3, where the plaintiff employees sued for overtime, and the defendant moved to stay the action pending arbitration under the collective bargaining agreement. The order on the motion was held appealable. A similar case also involving a suit for the overtime wages, and also one where the defendant set up the collective bargaining agreement providing for arbitration, the order thereon was also held appealable, was Gatliff Coal Co. v. Cox 6 Cir. '44, 142 Fed 2d 876. International Union v. Colonial Hardwood Floors 4 Cir. '48, 168 Fed 2d 33 was an action under Sec. 301 upon a collective bargaining agreement for damages arising from a strike. The Union moved for a stay pending arbitration under the collective bargaining agreement. A denial of the order was held appealable.

American Locomotive Co. v. Chemical Research Corp. 6 Cir. '48 171 Fed 2d 115 (cert. den. 336 U. S. 909) was an action for breach of contract involving a license to manufacture and the motion was made to stay the action pending arbitration. The Court held that order, though interlocutory, was appealable.

Hudson Lumber Co. v. U. S. Plywood Corp. 9 Cir. 1950 181 Fed. 2d. 929, involved a declaratory relief action where the defendant obtained an order staying the action pending arbitration under the contract provisions. This interlocutory order was held appealable.

Wilko v. Swan 2 Cir. '53, 201 Fed. 2d 439 held that an interlocutory order denying a stay in a motion to have arbitration under a written margin agreement between the customer and broker in the principal action for violation of the Federal Securities Act, was appealable.

Baltimore Contractors, Inc. v. Bodinger 348 U. S. 176 involved an equitable action brought in the State Court and removed to the Federal Court for diversity. There was a motion for a stay under the Arbitration Act as the contract, the subject of the equitable State Court action, provided for disputes on matters of mathematics and computations to be determined by a named auditor, and his determination would be binding. The Court held that this was not an agreement to arbitrate but was limited solely to mathematical disputes, that it was a purely equitable action and a stay order is not an injunction; but in legal action, it is an injunction to stay the action and is appealable. The appellees cite Wilson Brothers v. Textile Workers 2 Cir. 55, 224 Fed. 2d 176 involving a suit in equity to avoid the duty to arbitrate under a collective bargaining agreement, the Court stayed the action pending arbitration. The Court held that this was not an appealable order as the Court cannot abandon the distinction between law and equity under the former practice. The order is appealable if it is an action at law, and it is not appealable if the suit is wholly equitable.

II THE ORDER REFUSING TO ENFORCE JUDGE SWEIGERT'S ORDER FOR ANSWERS TO INTERROGATORIES IS AN APPEALABLE ORDER.

Appellants' Opening Brief assumed that since the order requiring arbitration was clearly appealable, the Court on appeal would review all matters in the record, including the refusal of this District Court to enforce Judge Sweigert's order directing the defendant PMA to answer the interrogatories, many of which were addressed to the evidences of and what constituted the collective bargaining agreement, as well as whether the proper parties were before the Court, and leads to evidence.

It should be noted that there were many millions of dollars not

represented by the trustees of the jointly trusteed funds Report to the Federal Government, (Depos. Ex. 44, 45 & 46) and the monies testified by Mr. St. Sure in his deposition, to have been paid to these trustees created in part by labors of the plaintiffs. Appellees' Brief does not even comment on this. It is necessary to have all of the parties who hold these funds before the Court in order to have a complete adjudication. Interrogatories were addressed to this matter.

Appellees cite Howard Term. v. U. S. 9 Cir. '56, 239 Fed. 2d 336, a case seeking to set aside and review an order of the Maritime Board dismissing some of the grounds of the appellants' proceedings before the Board, but leaving other allegations going to the validity of the operating agreement, upon which the appellants might well have their complete relief. This Court held that this motion to dismiss as to part of the Board's proceeding and the order thereon, was not a final and appealable order. It differentiated Isbransten Co. v. U. S. 93 U. S. App. D.C. 293, 221 Fed. 2d 511, where an order of the Board for dual rate system was put into effect in 48 hours and directing subsequent hearings upon the appellant's protest was appealable and reviewable, because the Isbransten case order had an immediate effect and consequences upon the petitioner, and the order appealed from would cause the appellant to suffer real and immediate harm.

Appellees cite and quote from Collins v. Miller '20, 252 U.S. 364, involving a habeas corpus upon extradition proceedings under a treaty with Great Britain in which the Commissioner took testimony and permitted the defendant to offer testimony as to one charge, but notas to the two other charges pending in India against him. A writ of habeas corpus was granted as to the two charges, but denied as to the one for which the petitioner was granted a hearing and opportunity to give evidence, and the matter was referred to the Commissioner for further proceedings to take testimony and to permit the petitioner to give testimony on the two charges in which he was

denied his prior hearing. The Collins case held that the habeas corpus order had not disposed of the case and that the order was not final and not appealable. No such circumstances exist in the case at bar, nor do the facts even approach or present the same rules of law as those involved in the Collins case.

Appellees cite Cobbeldick v. U. S. 309 U.S. 321 involving an appeal from an order denying a motion to quash a subpoena duces-tecum before a grand jury. The Court pointed out that if the appellant refuses to comply, he may be committed for contempt and that he could appeal from that order of contempt. The Court differentiated this situation from a patent suit where the grand jury sought to obtain an order to produce documents in the patent suit and the Court held the order appealable as mischief would be done by the order appealed from, but that in ordinary criminal cases where a witness is subpoened to appear and produce documents before a grand jury, such delays as the appellant sought affected the orderly processes of criminal justice.

Appellee cites DiBella v. U. S. 369 U.S. 121 involving a motion to suppress evidence in a criminal case, obtained by an unlawful search and seizure. The Court held that in post indictment motions, the order refusing to suppress the evidence was not appealable, but the rule is otherwise where there was a motion for return of property if there was no criminal prosecution in existence, in which case the order of denial is appealable.

Appellee cites U. S. v. Woodbury 9th Cir. 263 Fed. 2d 784 involving discovery proceedings in a civil action under the Tort Act. In the Woodbury case the Court held that if there were no "controlling questions of law", the District Court cannot grant leave to appeal under Sec. 1292 (b), and this question of "controlling question of law" is reviewable by the Appellate Court. No such problem or question is presented in this appeal.

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Appellee cites U. S. v. Rosenwasser 9 Cir. 263 Fed. 2d 784, involving an appeal from an order granting a motion to suppress evidence from an illegal search and seizure. The Court pointed out that there is no statutory authority for the Government to appeal from an order to suppress or return evidence for illegal searches and seizures.

Appellee cites Hartley Pen Company v. U. S. District Court, 9 Cir. '61 287 Fed. 2d 324, involving a writ of mandate to set aside a District Court order directing a discovery in a breach of warranty suit. The discovery was directed to the trade secrets in the ink used in the ball point pens, and was directed to matters which were not the subject of the suit. The Court granted the writ, holding that the disclosure would cause irreparable damages and force the party to abandon his suit or suffer this irreparable damage from the disclosure.

In the case at bar, the interrogatories ordered answered, in a large part, go to the very issues of what is the collective bargaining agreement, its proof and its evidences, and whether the proper parties are before the Court for a complete adjudication. The interrogatories are also addressed to the existence of evidence such as documents, records and identity of persons who can testify on deposition. The interrogatories are in page 6 et seq. of the Record.

Discovery is not open to the parties during arbitration. A deposition may not be taken when all proceedings are stayed for arbitration.

4 Moores Fed. Prac. 1092 Note 3

Discovery is not available to parties in arbitration.

Comm. Solvent Corp. v. La. Liq. Fertilizer Co. D.C.-N.Y. '57 20 FRD 359.

Penn Tanker Co. of Del. v. C.H.L. Rolimpex D.C. N.Y. '61 199 Fed. Supp. 716.

Parties to arbitration under Sec. 301(a), do not have the right of discovery.

Penn. Greyhound Lines v. Amalgamated Assoc. etc. D.C.-Pa. '51 98 Fed. Supp. 789 (rev. on other grounds 193 Fed. 2d 327)

Note: The District Court decision in the Penn. Greyhound Lines, in 98 Fed. Sup. 789 is cited with approval in Drakes Bakery v. Local 50, 370 U. S. 254 at 262, Footnote 9, for another proposition.

Without the aid of the Federal rules and their discovery procedure, the appellants are very badly prejudiced and may well forfeit much of their rights for lack of proof. For example see Amended Compl.p. 23-4(R-42-3).

It may then be safely stated that under the doctrine of the cases cited by the Appellees' Brief, mentioned above, irreparable damage and injury is certain to result to the plaintiffs, and therefore this order denying sanctions is properly appealable.

It should be pointed out that on the factual issues as to what was the collective bargaining contract when the action was commenced, determines the question as to whether the contract does in fact require the issues to be arbitrated. Under no rule of law may the plaintiffs be denied their discovery going to these issues as to what constitutes the contract, and as to whether the proper parties are before the Court for a complete adjudication, and therefore the order denying enforcement of Judge Sweigert's order requiring answers to the interrogatories is clearly appealable.

III OBLIGATION TO ARBITRATE

Arbitration is a matter of contract, and a party cannot be required to submit to arbitration any dispute he has not so agreed to submit.

Atkinson v. Sinclair Refining Co. 370 U.S. 238;

United Steel-Workers v. Warrior Nav. Co. 363 U.S. 574, concurring opinion at 582;

Drakes Bakery v. Local 50, 370 U.S. 254 at 262, Footnote 9.

There is no contract to arbitrate the issues in this action set forth in the Amended Complaint, commencing with the Master Agreement for Clerks.

The defendants are sued at law for a breach of their contract, and having violated their contract, and failed to observe it, seek to defend on the grounds that the disclosed written contract is not the contract in effect, but claim that there is an oral agreement between the defendants that the Longshore Agreement, designated by them as the "Gray Book", providing for arbitration when there is discrimination against a non-union longshoreman applies to these ship clerk plaintiffs. The affidavits on the motion for summary judgment place in issue the contract and its provisions. It also pleads the fact that before the action was filed, demand was made to arbitrate, if there were any contract provisions as to arbitration, and this the defendants refused to do. Now having required the plaintiffs to bring their action by refusal to arbitrate, they ask to stay the action necessitated by their refusal. Nine months elapsed between the commencement of the action and the motion for summary judgment and for the stay and for arbitration. Their conduct and defense of the litigation for this period without moving for the stay and requesting arbitration, is clearly a waiver. Furthermore, in a similar matter involving another ship clerk, Roper, there was no arbitration permitted. In the action involving different parties in the State Court, known as Andrews v. PMA, the defendant PMA, and defendant Union having obtained a stay, both protested any attempt to arbitrate and have delayed even a hearing on the merits before the defendants' own arbitrator for a full calendar year, and at every turn contend there is some secret contract provision not theretofore disclosed, which is an excuse for a delay or prevention of any arbitration hearing or a determination on the merits. An order which stays proceedings pending arbitration, on some unknown, undisclosed and nebulous contract, is hardly a remedy. Its effect is final and irreparable.

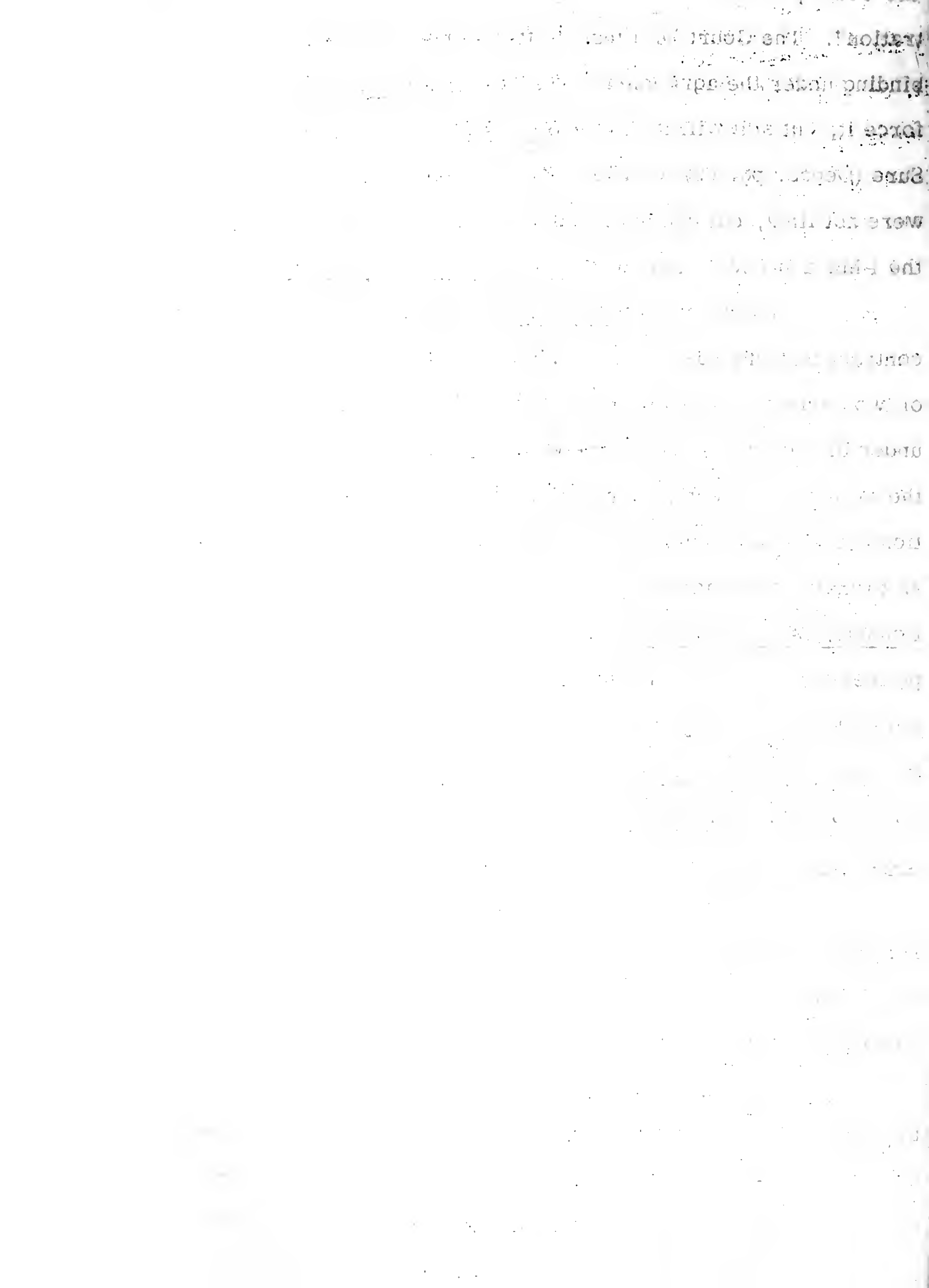
Appellees cite Drivers Union v. Riss & Co. 372 U.S. 517, an action to enforce an award under a collective bargaining agreement. There

the Court pointed out that the agreement need not use the word "arbitration". The Court held that if after a trial, the award is not final and binding under the agreement, no action under Section 301 will lie to enforce it, but suit will lie under Sec. 301 for breach of the contract. St. Sure (Depos. pg. 69) testified that arbitrators' awards under the contract were not final, but can be and are actually modified by agreements between the PMA and ILWU. See also Edwards v. Cap. Airlines 176 F2 754.

Appellees cite Humphrey v. Moore 375 U.S. 335 involving a contract that provides where seniority is an issue due to the consolidation of two carriers, it shall be determined by a certain committee existing under the contract, and in line with Elgin J.E.R. Co. v. Burley, 325 U.S. 711, the exclusive collective bargaining agent has authority to make determinations as to future conduct, but does not have power to bind the individual as to matters of past acts, remedies, and rights thereunder. See Donnelly vs. United Fruit Co. 40 N.J. 61, 190 A. 2d, 829, cited by Appellees and containing an interesting discussion, including the duty of the collective bargaining agent to act impartially for all employees and citing the Ford Motor Co. case 345 U.S. 330, Steele v. Louisville, etc. R. Co. 323 U.S. 192, Gainey v. Brotherhood 3 Cir. 313 Fed. 2d, 318, and Hughes Tool Co. v. NLRB 5 Cir. 147 Fed. 2d, 69.

None of the cases cited by Appellees require arbitration where it is not required by the contract. None of these cases cited by Appellees require an employee to submit his disputes for determination to his adversaries for their decision.

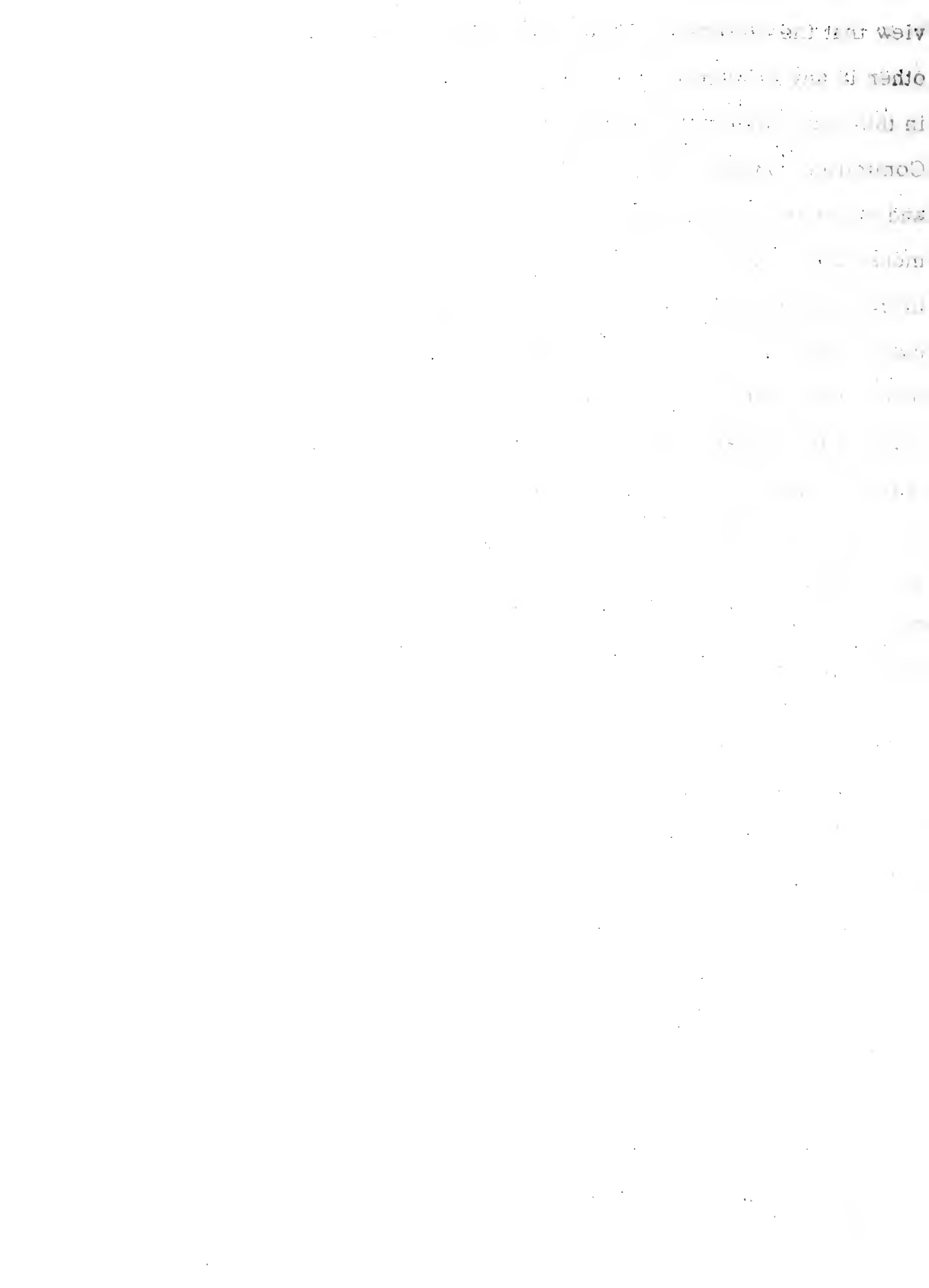
The bargaining agreements are very cleverly drawn to prevent the plaintiffs, and those similarly situated, from having any remedy at all before any so-called grievance machinery. The sole right granted is that to go before the defendant Port Committee and to ask this Committee to pass upon its own wrongful acts in refusal to perform the contract as to



registration and dispatch. Indeed, these agreements are drawn with a view that the defendant, PMA, is on one side, and the Union is on the other in any grievance procedure, and none provide for the situations in this case, where the principal contract violator is the defendant Port Committee consisting of members selected and directed by the Employers and members selected and directed by the Union, and in which a unanimous vote of one vote to each side is necessary for any action, and only in the event of their failure to agree, (and they agree in all matters in the case at bar) may any matter go to arbitration. Only when there is a dispute between PMA and the Union can it go to arbitration, and the arbitrator's powers are very carefully limited and prescribed. The arbitrator is one who holds his lucrative position at the pleasure of the PMA and the Union, and no one in the plaintiffs' position would expect the arbitrator to act contrary to his own financial interests, should it ever reach a point to where these defendants, PMA and ILWU, should disagree, which they have not done in this case.

IV <u>PENDANT JURISDICTION</u>

This Court has held that where the written agreement grants preference of registration and dispatch to Union membership, the contract is illegal and void. The ILWU and PMA have not changed their stripes, but they have written their contract to appear innocent upon its face, nevertheless still granting the priority of registration and dispatch to Union members in the manners set forth in our Briefs and in the plaintiffs' Amended Complaint. It is just as wrong for the defendants, PMA and ILWU, to grant priority and preference to registration and dispatch to Union members in violation of the contract, as it is to make the written contract that came before this Court and was held void because it granted this priority of registration and dispatch to Union members. It is also



wrong to violate contractual obligations by acts which are also violation of the specific covenants in the collective bargaining agreement against discrimination for lack of union membership.[1]

The Federal Court having acquired jurisdiction, may proceed to a complete adjudication of all matters involved in the litigation even though these other matters involved are matters solely of general law within state court jurisdiction. Federal Courts adjudicate all matters involved and are not limited to the matters conferring Federal Court jurisdiction.

Railroad Comm. v. P.G. & E. 302 U.S. 388, 82 Law Ed. 319;
Hopkins v. So. Cal. Tel. Co. 275 U.S. 393, 72 Law Ed. 739;
Chicago, etc. Ry. Co. v. Kendall, 266 U.S. 94, 69 Law Ed. 183;
United Fuel Gas Co. v. Ry. Comm. 278 U.S. 300, 73 Law Ed. 390.

The Federal Court having jurisdiction on one ground, had the right and duty to decide all questions in the case even though it decided the Federal question adverse to the plaintiff or even if it omitted to decide the Federal question and decides the case on a point of State law question not involving Federal Court jurisdiction.

Hurn v. Oursler, 289 U.S. 238.

This is sometimes called jurisdiction of non-federal claims "pendant" to District Court jurisdiction.

Ellis v. Carter, 9 Cir. 291 Fed. 2d 270.

An example appears in the complaint where the plaintiffs plead

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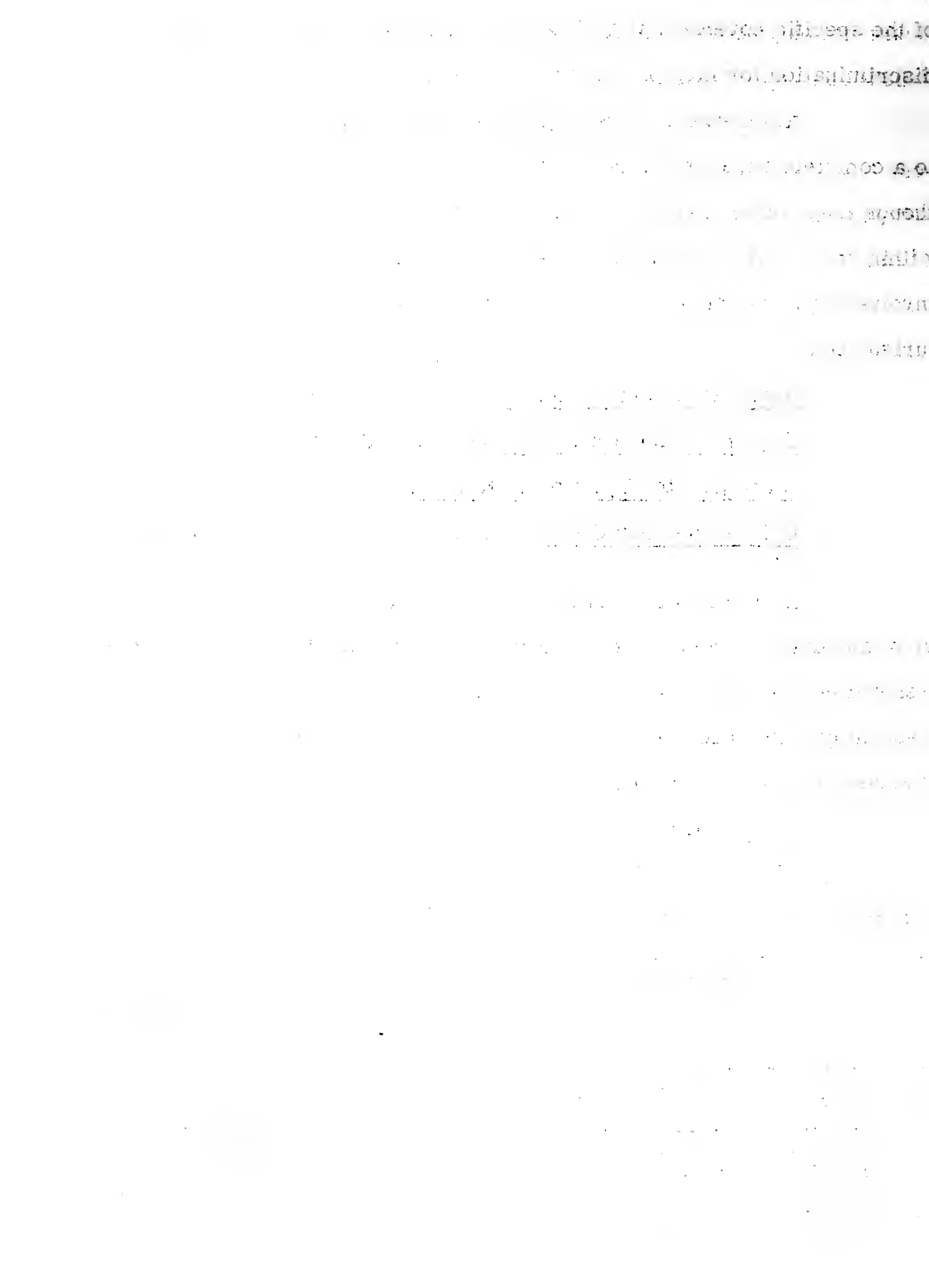
1/ Mr. St. Sure testified on his deposition (Depos. pgs. 98-9) that the clause against discrimination against non-union employees has been a part of the maritime contracts for many years. As recently as the Memorandum of Agreement of June 22, 1962 (Depos. Ex. 21), there was a specific provision and covenant against discrimination applicable to all the various maritime contracts including the Ships Clerks.



the employment by the Union and compensation of the Union as their agent, not only as an agent for hire, but also the statutory exclusive collective bargaining agent, and the violation of this agent's duty.

In an action under Section 301, upon the collective bargaining contract, the fact that the breach of contract is also arguably within the definition of an unfair labor practice, does not divest the court of jurisdiction. If there were any question on this point, it is forever closed by the direct holding in Doyle Smith v. Evening News Association 371 U.S. 195, 9 Law Ed. 2d, 246. It is also the holding in:

Dowd Box Co. v. Courtney 268 U.S. 502, 82 S.Ct. 519;

Teamsters v. Lucas Flour Co. 369 U.S. 95, 7 L. Ed. 2d 593;

Plumbers, etc. v. Dillion 9 Cir., 255 Fed. 2d 820;

Indep. Petr. Workers v. Esso Std. Oil Co. 3 Cir., 235 Fed. 2d 401;

Machinists v. Cameron Iron Works 5 Cir. 258 Fed. 2d. 467.

Appellees' Brief contends that because appellees' breach of this contract also amounts to an unfair labor practice, these allegations of the amended complaint should be disregarded. Their Brief forgets the "pendant" to Federal Court jurisdiction rule that permits the Federal Courts to make a complete adjudication of all matters, including matters cognizable at law before the state courts, such as violation of an agent's duty to its principal.

V. SEPARATE TRIALS OF ISSUES

Appellees' Brief attempts to justify a determination of the terms of a contract upon conflicting affidavits and determination that there is a contract to arbitrate, and the complete disregard of the issues of waiver and estoppel, by the power of the Court under Rule 43 (b) that a Court can order separate trials on any claim, cross-claim, counter-claim, or third-party claim or issues.

Appellees' Brief seeks to justify the refusal of the Court to enforce Judge Sweigert's orders to answer the interrogatories, upon the contention of separate issues.

The error appears when the only issues drawn are those upon the affidavits for summary judgment as to the existence or non-existence of a written contract provision to arbitrate, and upon the issues of waiver and estoppel. There have been no issues drawn by any responsive pleading in the form of an answer to the Amended Complaint. Until there has been an answer filed, no one can state what the actual issues of fact are in this case to decide which shall be tried first.

5 Moores Federal Practice 121, Section 43.03, in discussing Rule 43(b) points out that a single trial generally tends to lessen delay, expense and inconvenience to all concerned, and that the Courts often emphasize that ordering separate trials are only justified when such a disposition is clearly necessary, as for example, the defense of the statute of limitations, release, statute of frauds, invalidity of patents, or other defenses would make unnecessary the trial of more complicated issues in the case. This treatise points out the severance of issues are also only justifiable when there are permissive counter-claims wholly unrelated to the principal cause of action or there are third-party claims joined under Rule 18(a).

In the case at bar, the issues as to what is the written contract and whether it provides for arbitration are issues of fact to be tried before a jury.

When the written contract is determined, it is then a question for the District Court to determine whether the case has any arbitrable issues under that contract, and what they are.

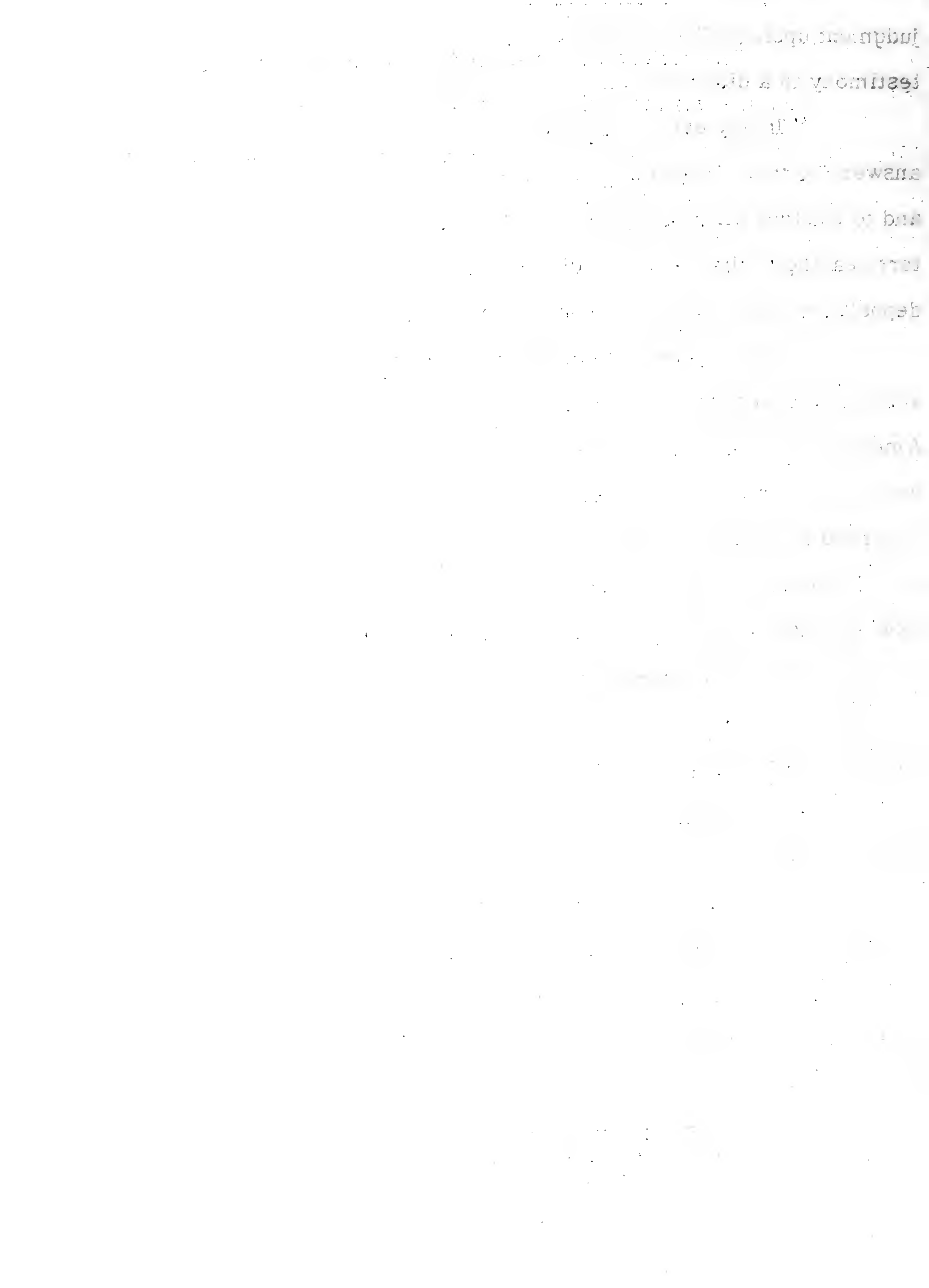
There is also the issue of waiver and estoppel that involve questions of fact, which must be tried by a jury.

None of these factual issues can be determined by summary judgment upon conflicting affidavits, nor can they be determined by the testimony in a discovery deposition contrary to opposing affidavits.

In any event under any theory, the plaintiffs are entitled to answers to their interrogatories addressed to what is the written contract, and to whether all of the proper parties are before the Court, and to matters leading to the discovery of persons competent to testify upon oral depositions, and to the existence of documentary evidence.

It is a general principle applicable to actions at law that legal actions be brought by the person whose legal rights have been affected. The Amended Complaint (R-20) pleads legal rights of the plaintiffs and appellants based upon the written collective bargaining agreement that have not been observed or performed by the defendants. How plaintiffs' "standing to sue" is in issue without an answer being filed, we are at a loss to understand. How any discovery can be limited by a non-existent issue of plaintiffs' "standing to sue" is not explained. There may be some factual basis not yet disclosed in any pleading. Until it is pleaded, the plaintiffs are entitled to discovery and to enforcement of Judge Sweigert's order to answer their interrogatories. (R-84). The defendants' "Notice of Motion for Separate Trial of Issues, etc." (R-119) specified no basis other than "standing to sue" without mention of any grounds. Their "Memorandum of Points and Authorities in Support of Motion for Separate Trial of Issues of Plaintiffs' Standing to Sue and Motion to Limit Discovery to Matters Relevant to said Issues" (R-123) states the sole grounds on lines 13 to 16, page 2, (R-124):

> "The question of plaintiffs' standing to sue goes to the question of whether plaintiffs have stated a cause of action, which question is broadly raised by defendants' previous motions filed May 6, 1963."



CONCLUSIONS

1. The actions by the Amended Complaint are at law under Sec. 301 upon the written collective bargaining agreement, both to recover monies due under that contract by a money judgment, and for damages for breach. Any injunction or stay order staying this action is clearly an appealable order, whether the order is interlocutory or final.

2. District Judge Sweigert made an order directing the defendants to answer interrogatories upon discovery. The defendants refuse to comply with the said District Court's order, and the only remedy remaining is to impose sanctions for failure to obey the lawful order of the District Court. Answers to the interrogatories are necessary to not only discover the persons from whom depositions may be taken and to ask for the production of written evidence, but it also goes to the existence of and the evidence of the very collective bargaining agreement in dispute and to determine its terms. It also goes to the point as to whether all of the proper parties are before this court, particularly those who hold a large part of the jointly trusteed funds that do not appear from the Federal Reports (Depos. Ex. 44, 45 and 46).

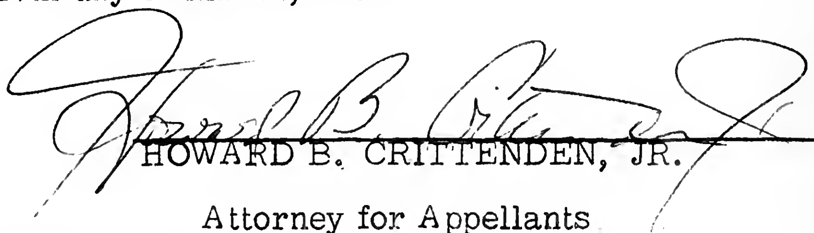
3. The contract of 1948 was declared illegal and void by this Court because the said contract granted priority of registration and dispatch to union members. By clever draftsmanship, creating an innocent appearing seniority date, and by breach of the contract, and by breach of the common law duty of an agent to its principal, this practice has been continued, and priority of registration and dispatch, that was held void, has been continued unabated and unchanged by this Court's important adjudication. The plaintiffs are entitled to their action at law under Section 301 to enforce this contract and recover their unpaid compensation and benefits for their services, and they are entitled to recover their action at law for damages for breach of the contract. Any order undertaking to

restrain and enjoin or to stay this legal action, is an order that is appealable, regardless of whether the order is a final order or an interlocutory order, by express act of Congress and by numerous decisions of the Federal Courts.

4. Discovery is necessary to not only determine the actual contract, and whether it is in fact one in writing containing an applicable arbitration provision, and what these present arbitrable issues are as a matter of law, but this discovery is also most essential to properly present the particular case to any tribunal, court or arbitrator. Any order denying this discovery, not only prevents the plaintiffs from making the necessary proofs as to the contract and its terms, but it also prevents the plaintiffs from presenting and obtaining the necessary evidence to show the long series of conducts that constitute the violation of the contract, and of the agent's duty to the principal. Discovery is also necessary to determine whether the proper parties defendants are all before the Court for a complete adjudication. It is necessary to prove much of the damages.

5. It is respectfully submitted that before the plaintiffs are completely denied all effective remedy, that they should have their day in Court for a determination of the facts as to the contract, and what this contract actually contains, and that it should not be determined upon a motion for summary judgment upon conflicting affidavits. The factual issues of waiver and estoppel must also be tried, and cannot be disposed of by affidavits, which facts we might point out are not even denied by the defendants.

Dated: This 27th day of March, 1964.



HOWARD B. CRITTENDEN, JR.

Attorney for Appellants

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No. 18916

In the

United States Court of Appeals

For the Ninth Circuit

KINCAID & KING CONSTRUCTION COMPANY, INC., a corporation,

Appellant,

vs.

THE UNITED STATES OF AMERICA, for the use of WILLIAM OLDAY; CONTINENTAL CASUALTY COMPANY, a corporation; and UNITED STATES FIDELITY AND GUARANTY COMPANY, a corporation,

Appellees.

On Appeal From The

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ALASKA

BRIEF FOR APPELLANT

FILED

OCT 30 1963

FRANK H. SCHMID, CLERK

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No. 18,916

In the

United States Court of Appeals

For the Ninth Circuit

KINCAID & KING CONSTRUCTION COMPANY, INC., a corporation,
Appellant,

vs.

THE UNITED STATES OF AMERICA, for the use of WILLIAM OLDAY; CONTINENTAL CASUALTY COMPANY, a corporation; and UNITED STATES FIDELITY AND GUARANTY COMPANY, a corporation,

Appellees.

ON APPEAL FROM THE

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ALASKA

BRIEF FOR APPELLANT

SUPPLEMENTAL
JURISDICTIONAL STATEMENT

This is an action brought under the Miller Act (Title 40 U.S.C.A. §270(b) by the appellee, William Olday against the appellant, Kincaid & King Construction Company, Inc. and Anchorage Builders Inc. and their bonding company, United States Fidelity and Guaranty Company on October 29, 1956. (Record on Appeal p. 1-7).

A judgment was duly entered on October 23, 1958 in the District Court for the District of Alaska, Third Division at Anchorage, in favor of the appellee, William Olday, and against the defendants; Kincaid & King Construction Company, Inc., United States Fidelity and Guaranty Company and Anchorage Builders, jointly and severally, in the total sum of $30,000.00, plus attorneys' fees in the amount of $2,000.00 plus interest at the rate of six percent (6%) per annum from date of entry. An appeal was taken from that judgment by the appellant, Kincaid & King Construction Company, Inc. to this court. That appeal was dismissed by opinion of this court in No. 16,519 on February 21, 1962 on the grounds that no final judgment had been entered since there was no disposition of the appellant's counterclaim. The case is cited as Kincaid & King Construction Company v. United States, 299 F. 2d 787 (9th Cir. 1962.) A hearing upon the remand of the case took place at Anchorage, Alaska before the Honorable Harry C. Westover, United States District Judge on May 27, 28 and 29, 1963. A supplemental judgment and supplemental findings of fact and conclusions of law were entered on May 29, 1963. From this judgment, the appellant filed a timely notice of appeal to this court on June 22, 1963. Jurisdiction of the court below was conferred

under provisions of §270(b), Title 40, U.S.C.A. Jurisdiction in this court is conferred by 28 U.S.C.A. 1291.

SUPPLEMENTAL STATEMENT OF CASE

This statement of facts is supplemental to the statement of the case contained in appellant's opening brief in No. 16,519. A hearing upon remand of this case occurred at Anchorage, Alaska on May 27, 28 and 29, 1963. At this hearing upon remand, the trial judge refused to entertain any evidence whatsoever on the appellant's counterclaim against the appellee, William Olday. Appellee, Continental Casualty Company, moved that since the cause had been fully tried, there was no occasion for the taking of any further testimony and that the court merely enter appropriate findings of fact and conclusions of law and a supplemental judgment denying the counterclaim of the appellant, Kincaid & King, (Tr. of Hearing Upon Remand, p. 22, lines 22-25; p. 23, lines 1-20.) The appellees, Olday and United States Fidelity and Guaranty Company, joined in this motion. The trial court indicated that he had prohibited appellant's counsel at the previous trial from introducing testimony relative to the appellant's counterclaim. The court said during hearing for remand:

"THE COURT: Counsel, that's not entirely correct because Mr. Arnell on several times attempted to introduce

testimony relative to this counter-claim and I refused to allow the testimony to come in. The record will show that I refused to allow it. However, I think testimony was introduced but the record shows that I refused to allow him to introduce it.

MR IVERSON: I think it was introduced Your Honor and it went on for some time.

THE COURT: And Mr. Arnell always took the position that he wasn't given the opportunity to present that issue to the Court." (Tr. of Proceedings on Remand, p. 23, lines 21-25, p. 24, lines 1-5.)

Appellant made a motion at the hearing on remand to the trial court to reconsider the admission of appellant's exhibits "W" and "U" for identification. (Tr. 51, lines 10-15.)

The appellant also made at the request of the court an exhaustive offer of proof of the matters which appellant wished to present in support of its counterclaim against the appellee, Olday (Tr. on Remand, pp. 121-124.)

The trial court in the proceedings on remand indicated that he had no jurisdiction to change the findings or the

judgment as those findings and judgments had become final. (Tr. on Remand, p. 115, lines 6-8.)

The trial court refused to go into the matter of the third party complaint on the basis that the third party complaint was directed only against Continental Casualty Company and that since liability had to be first established on the complaint against the principal, Olday, that the third party complaint had to be dismissed. The court said in this regard as follows:

> "This third party complaint was directed only against the Continental Casualty Company as third party defendant and this third party complaint should have been dismissed, and it was dismissed." (Tr. on Remand, p. 90, lines 18-21.)

Appellant filed timely objections to the supplementary findings of fact and conclusions of law. (See record on appeal, p. 180-184.) These objections were overruled by the trial court. (Tr. on Remand, p. 152, lines 11-16.) The trial court rejected any proof on the appellant's counterclaim on the grounds that he distrusted the records, and also because the appellant went back and reviewed their records to see whether or not they couldn't build up an offset against

Olday's claim. This appeared to be the only basis for the denial. The court said as follows:

> "THE COURT: Well, counsel, I've had considerable experience relative to accounting and bookkeeping methods, and if Mr., if Kincaid and King had kept a book of accounts in which it had a ledger sheet, and in that ledger sheet had put in from time to time the amount of the back charge, I probably would have accepted it. But you see, they didn't have any record at all. All they did, they, their books didn't show any record. All they did is when this complaint was filed, then they went back and reviewed their records to see whether or not they couldn't build up an offset against this claim, which they did. And I think I had a right to disregard and distrust that record. I'm still of the opinion that I should have distrusted it and consequently it was in my prerogative not to consider it." (Tr. on Remand, p. 141, lines 8-20.)

It should be noted that at the time of the hearing on remand, that a substantial portion of the back records for exhibit "U" had been burned subsequent to the litigation. (Tr. 137.)

The appellant's offer of proof and motion to reconsider the admission of certain exhibits were denied and supplemental judgment and findings of fact were duly entered. (Tr. on Remand, p. 152.)

QUESTIONS PRESENTED

1. Was finding of fact X erroneous in any particular?

2. Was finding of fact XI erroneous in any particular?

3. Was finding of fact XII erroneous in any particular?

4. Was the trial court erroneous in finding that the appellant caused extra work by failing to stake the area where the appellee, Olday, was required to work?

5. Was supplemental finding of fact I erroneous in any particular?

6. Was supplemental finding of fact II clearly erroneous in any particular?

7. Was supplemental finding of fact III clearly erroneous in any particular?

8. Did the trial court commit reversible error in refusing to entertain evidence on appellant's counterclaim?

9. Did the trial court on remand properly dispose of appellant's counterclaim as required by this court in its opinion filed February 21, 1962?

10. Was it error for the trial court to refuse any evidence on appellant's counterclaim because the amount of the counterclaim was compiled after the original litigation commenced?

11. Was it error for the trial court to dismiss the appellant's counterclaim with prejudice?

12. Was it error for the trial court to dismiss appellant's third party complaint with prejudice?

SUPPLEMENTAL
SPECIFICATIONS OF ERROR

1. The appellant adopts the specifications of error set out in appellant's opening brief in No. 16,519 and incorporates the same herein by reference.

2. The trial court erred in refusing to admit into evidence on appellant's motion to reconsider the court's previous rulings at the original trial defendant's exhibits "U" and "W" for identification. (Tr. of Hearing upon Remand, May 27-29, 1963.) The following motion was made at page 51, lines 10-15, Transcript of Hearing upon Remand as follows:

> "MR BONEY: Your honor, I would like to respectfully submit that the rejection of defendant's exhibit "W" for identification and defendant's exhibit "U" for identification

which were never admitted into evidence should be reconsidered and that the grounds stated by the Court would only go to the weight and not to the admissibility."

The court disposed of the matter as follows:

"THE COURT: Well, now counsel, this is not a new trial and this case has not been opened up for any additional testimony. This is not a motion--we have no motion for a new trial. In fact a motion for a new trial is too late and the Court, the Circuit Court hasn't ordered a new trial. The Circuit Court has only said, "you haven't made any finding relative to the counter-claim and so till you do we don't have any jurisdiction."

Appellant's trial counsel retorted:

"MR. BONEY: Well, if the Court, maybe I was misled by the letter of the Court which advised me that additional testimony would be taken on the counter-claim. I must confess."

The Court retorted as follows:

"THE COURT: Well, I probably should have said additional testimony will be taken if I find it's necessary."

3. The trial court committed reversible error by refusing to allow appellant, Kincaid & King Construction Company, Inc. to introduce any evidence on its counterclaim during the hearings which commenced May 27 and ended on May 29, 1963, at Anchorage, Alaska and by rejecting the appellant's offer of proof. The offer of proof was requested by the court. (Tr. of Hearing upon Remand, p. 121, lines 19-25.) The following offer of proof was made:

> "THE COURT: Well now, may I ask you to do this. Assuming that I would reopen this matter and allow you to produce additional testimony. Would you make an offer of proof now as to what testimony you will introduce and point out where it was not introduced in the record? Now what testimony do you want to introduce here. Let's have an offer of proof here."
>
> The appellant then made the following offer of proof:
>
> "MR. BONEY: We would your Honor make an offer, we would bring Mr. Smith back to the stand and he would continue his testimony concerning exhibits "W" and exhibits "U" and exhibit "W".
>
> THE COURT: May I see exhibit "W" and exhibit "U", you've referred

to them two or three times. Let me take a look at them and see what they are.

MR. BONEY: Exhibit "U" by the way goes to the, goes to liability on the counterclaim despite Mr. Josephson's statement to the contrary. They're weekly job site reports. We have other backup evidence in the record, E-1, 2 and 3. We will hand up exhibit "W" and this would be in the nature of an offer of proof. This is the amount of our delay damage, this is the break-down of our delay damage. "W" is based on the, in part on the Government inspection reports. And we would also prove, we would prove that the delays of Olday and breaches of the subcontract by Olday caused our client an additional $49,171.57 and it is broken down on exhibit "W". And then we would present additional proof showing that we would have incurred damages in addition to that amount in the amount of $27,360.00 as the result of additional overhead and engineering costs resulting from Olday's failure to complete the agreed time schedule. Mr. Smith who was ~~the~~ project manager would bring such necessary evidence as would be necessary to support those claims and would give

such additional testimony as to having to maintain supervisory personnel on the job, additional bookkeeping, and additional expense items during the period in which the delay occurred. And it should be noted that this amount does not include the charge backs that we have on O-1 I believe. We would probably also present George Hedla who is the witness and present custodian, who is the accountant for the defendant corporation Kincaid and King, and ah, to bring such company records that would be necessary to substantiate the $27,360 figure. And we maintain that the fact, as Mr. Arnell pointed out to the Court at 1103, he said--the Court said, "Sustained. Well he figured up a back charge of $49,171.51. He figured it up from his records but he didn't figure it up until after the litigation started." Mr. Arnell, "I concede Your Honor, that might go to the value of the weight of the evidence but certainly would not go the admissibility. And again Your Honor I would renew my offer of these documents to the Court." An objection sustained and apparently somebody, Mr. Arnell I think said, "I didn't hear an objection." And

> the Court said, 'Well, I'll object. If he didn't object he should have objected and so I'm going to sustain it anyway.' And we feel that proof has been cut off."

The trial court indicated that he would not admit the evidence and would stand by his former ruling despite the offer of proof. (Tr. of Hearing upon Remand, p. 129, lines 14-19, p. 130, lines 15-23, p. 141, lines 8-20.)

4. Finding of fact X is clearly erroneous in the following particulars:

In this finding, the appellee, Olday, was allowed and paid an "extra" by the appellants for the work covered by this award at the rate of $1.00 per cubic yard, which was in excess of the subcontract rate of $1.33 per cubic yard for excavations. (Tr. 1095, 1096.) This particular portion of findings of fact X is unsupported by evidence of record and should be set aside as erroneous. It is also erroneous for the further reason that the appellee, Olday, was bound by unit prices in a prime contract as estimated quantities were not exceeded by 25 percent.

This finding of fact was also erroneous in that the court awarded appellee, Olday, the sum of $422.00 for removing frost boils at the officers' mess

parking lot, back filling and recompacting. This award was based on the difference between the sum of $1,078.00 allowed and paid by appellant and the sum of $1,500.00 which the court deemed reasonable for the work. The allowance and payment made by the appellant to Olday was based on yardage prices in the subcontract and on an equivalent rental basis. (Tr. 1092, 1093, and 1094.) This finding in this particular is contrary to finding of fact VIII which found that the quantities approved by the government surveys were in fact quantities furnished by the appellee, Olday. This finding is erroneous in that the quantities furnished by the appellee, Olday, did not exceed the quantities specified in the contract by 25 percent and contract prices thereby prevailed. This finding was also supported by competent evidence of record. That portion of finding of fact X which allowed the appellee, Olday, the sum of $7,396.00 out of an award of $36,980.36 on allowance 106 made by the government to the appellant on an arbitrary formula which had no basis whatsoever in fact. This finding is erroneous in that the trial court in arriving at this allowance took a ratio on the appellee, Olday's subcontract price to the prime contract price and multiplied that by the award to the appellant and came out with

the award to Olday. Appellee, Olday, was not entitled to any portion of this claim because he had been paid for the work he had performed in accordance with the subcontract and most of the items had nothing to do with his work. (Tr. 1080 et seq.)

5. Finding of fact XI is clearly erroneous. This finding is not supported by competent evidence of record. Appellee, Olday, knew or had reason to know the time schedule for installation of the heater posts and the location of the heater posts, by an examination of the plans and specifications. (Tr. 1111.) Appellee, Olday, admitted that he could drive his equipment between the heater post and estimated that they were 20 feet apart. (Tr. 1175, 1181.) Olday could have anticipated the heater post situation and made his plans accordingly. Olday should be precluded from the allowance contained in finding of fact XI for the reason that he did not examine all the available drawings and plans concerning the prime contract. (Tr. 1181.) By implication, the trial court erred in finding that appellee, Olday, had no obligation to examine the plans and specifications despite the terms of his subcontract. (Tr. 1182.) This finding is erroneous for the further reason that there is insufficient evidence that the appellee, Olday, was in fact delayed in his work.

6. Finding of fact XII is clearly erroneous in that the trial court disallowed $5,000 of the back charge for curb area compaction in the amount of $8,182.53 on exhibit O-2. This portion of the finding was based upon no competence evidence showing that the back charge was unreasonable. This finding could not be supported by the time cards and records supplied by the appellant. (Tr. 1056-1058.)

Finding of fact XII is further erroneous for the reason that the trial judge disallowed a back charge for services rendered against Olday to the extent of $8,000.00 when such a disallowance was based upon insufficient evidence. This portion of the finding is erroneous because the trial court ignored the fact that the appellant supplied services to the appellee, Olday, in the season of 1956 which included cost of paying payrolls, cost of disbursing funds, interest on money advanced, presentation of weekly and monthly payrolls to the government, handling Federal and territorial withholding taxes for Olday's employees, and paying these taxes with appellant's funds, handling social security tax reports for Olday's employees and paying the taxes out of appellant's funds, preparation of territorial unemployment compensation reports and paying unemployment compensation contributions out of appellant's funds,

and performing all work in connection with payrolls of appellee, Olday.

7. Supplemental finding of fact I is erroneous in that the court cannot make a finding that the appellant, Kincaid & King, is entitled to no offsets and back charges without taking into consideration the basis of appellant's counterclaim against appellee, Olday. Moreover, this finding that appellee, Olday, substantially performed his subcontract is contrary to the clear weight of the evidence, in that Olday was guilty of delay and improper performance of his subcontract as is shown by the clear weight of the evidence.

8. Supplemental finding of fact II is clearly erroneous in that the court cannot make such a finding as to the reliability of the considering of appellant's evidence without first hearing, admitting and considering the same. The finding of fact is also erroneous in that the fact that the amount of the counterclaim or "back charges" in the amount of $49,171.57 were actually computed after the litigation began. This fact would only affect the weight and not the admissibility of this evidence. This finding is further erroneous because the trial court refused to consider all competent and material evidence relating to appellant's counterclaim.

9. Supplemental finding of fact III is clearly erroneous in that the trial court could not make such a finding without entertaining all evidence offered by the appellant, Kincaid & King, in support of its counterclaim. Also, this finding is premature because the trial court had failed to abide by the mandate of this court which required the trial court to dispose of appellant's counterclaim. This finding is also contrary to the clear weight of the evidence.

10. The trial court erred in its supplemental judgment in dismissing with prejudice the appellant's counterclaim and third party complaint.

11. The trial court committed error by refusing to properly dispose of appellant's counterclaim as required by this court in its opinion filed February 21, 1962.

12. The trial court erred in ruling that it would not entertain the counterclaim because the amount in the counterclaim was compiled after the original litigation commenced.

SUMMARY OF ARGUMENT

The trial court refused at the hearing on remand to entertain evidence on appellant's counterclaim in the following particulars:

1. By refusing to grant appellant's motion to reconsider the admission into its exhibits "U" and "W" for identification.

2. By refusing to allow appellant to call witnesses in support of its counterclaim against appellee, Olday.

3. By holding that since amount of counterclaim was compiled after litigation commenced that evidence concerning it was inadmissible.

4. By finding that the evidence on the counterclaim was unreliable and incredible without first hearing and considering evidence offered.

The trial court on remand failed to dispose of appellant's counterclaim as directed by this court for the reason that it could not dispose of the counterclaim without receiving evidence thereon.

Supplemental specifications of error numbers 4, 5 and 6 are argued in appellant's opening and reply briefs which are on file. The supplemental specifications are set out here to insure compliance with this court's rules 18 and 19. This argument merely supplements the argument made by the appellants in their opening and reply briefs which have been heretofore filed in this court in cause No. 16,519.

ARGUMENT

I. THE TRIAL COURT ERRED IN REFUSING TO ENTERTAIN EVIDENCE ON APPELLANT'S COUNTERCLAIM AGAINST OLDAY AT THE HEARING ON REMAND.

The trial court refused to entertain evidence on the counterclaim on the premise that the counterclaim was based upon records which were segregated and produced after the litigation commenced. The trial court persisted in its refusal to reconsider evidence on the same basis which it refused to receive evidence at the time of the original trial. (Tr. 1206, lines 6-14; Tr. on Remand, p. 141, lines 8-20; Tr. on Remand, p. 152, lines 11-16; Supplemental Finding of Fact II.)

The trial judge was apparently of the opinion that Mr. Arnell, appellant's counsel at the first trial, had not abandoned proof on the counterclaim as argued by the appellees on the previous appeal. (Tr. on Remand, p. 23, lines 21-25, p. 24, line 1.)

The trial judge on the hearing on remand, after hearing an offer of proof, refused to hear further testimony concerning the counterclaim. The trial court wasted the better part of three days without hearing any evidence

whatsoever and then summarily entering supplemental findings of fact and conclusions of law and a supplemental judgment.

Since the trial judge clearly indicated that he would not consider any evidence on the counterclaim, it is now apparent that the appellant's deceased counsel, Mr. Arnell, never abandoned the counterclaim. It is also clear, that a new trial must be granted to the appellant so that it may prove its counterclaim against the appellee, Olday. The reasons for rejection and dismissal of the counterclaim are erroneous. The trial judge should have considered evidence presented by the appellant and then after due deliberation made appropriate findings on the basis of the evidence. Therefore, this court has no alternative but to reverse this cause to the United States District Court for the District of Alaska with directions that the appellant be afforded a new trial on its counterclaim and also on its third party complaint against the appellee, Continental Casualty Company.

II. THE TRIAL COURT COMMITTED REVERSIBLE ERROR IN FAILING TO DISPOSE OF APPELLANT'S COUNTERCLAIM AS REQUIRED BY THIS COURT IN CAUSE NO. 16,519.

The trial court could not properly have ruled upon appellant's counterclaim without entertaining evidence on the same. The dismissal of the counterclaim with prejudice after hearing no evidence was error. Therefore, this court has no alternative but to reverse and remand this cause to the United States District Court for the District of Alaska with appropriate directions.

CONCLUSION

For the reasons stated in this brief and in appellant's opening and reply briefs in No. 16,519, this cause should be reversed and remanded to the United States District Court for the District of Alaska.

Dated at Anchorage, Alaska, this 26th day of October, 1963.

Respectfully submitted,

BURR, BONEY & PEASE

By: G. F. BONEY

APPENDIX OF EXHIBITS

Plaintiff's Exhibits

No.	Accepted	Rejected
38	22	
19	58	
6	61	
30	128	
31	146	
17	147	
37	152	
13	163	
16	164	
14	164	
29	165	
35	166	
11	169	
9	172	
4	179	
5	180	
7	183	
22	186	
23	188	
24	188	
25	189	
32	190	
18B	204	
33	1172	

Defendant's Exhibits

No.	Accepted	Rejected
J	28	
K	28	
D-1	148	
D	150	
C	256	
O-1	273	
AD	330	
12-A	591	
E	671	
AH	801	
E-2	813	
O-2	904	
N	932	
E-3	988	
AG	1046	
AJ	1048	
AK	1052	
AM	1064	
AE	1078	
AN	1080	
AB	1169	
AO	1178	
U		1100,1206
W		1100,1206 115 (Tr. on Remand.)

CERTIFICATION

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated this 26th day of October, 1963.

G. F. BONEY,

Counsel for Appellant

No. 18916

IN THE

UNITED STATES COURT OF APPEALS

For the Ninth Circuit

KINCAID & KING CONSTRUCTION COMPANY, INC.
a corporation,

Appellant,

vs.

THE UNITED STATES OF AMERICA, for the use of WILLIAM OLDAY: CONTINENTAL CASUALTY COMPANY, a corporation; and UNITED STATES FIDELITY AND GUARANTY COMPANY, a corporation,

Appellees.

ON APPEAL FROM THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ALASKA

BRIEF OF APPELLEE,
Continental Casualty Company, on Second Appeal

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ON APPEAL FROM THE
UNITED STATES DISTRICT COURT
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BRIEF OF APPELLEE, Continental Casualty Company, on Second Appeal

I

APPELLEES SUPPLEMENTAL STATEMENT OF CASE

This case was before this court previously and by opinion filed February 21, 1962, the appeal was dismissed for the reason that from the record it did not appear either from the findings of fact or judgment that the District Court had made any disposi-

tion or determination on Kincaid & King's counterclaim against Olday. In that opinion it was stated that if the matter should be returned to this court after disposition of all claims had been made, the parties on a new appeal might rely upon the records and briefs already filed with the court and with the record properly supplemented, such additional briefs might be filed as seem necessary and appropriate.

Since there is one record already on file, and an additional transcript of hearing upon remand has now been filed, we shall for convenience in this brief refer to pages in the record of the main trial as "(Tr.)." As, for example, "(Tr. 55)." And we shall refer to the record in the hearing on remand as "(R. Tr.)", standing for remand transcript. For example, "(R. Tr. 51)".

This matter came on for hearing after the issuance of the court's previous ruling at Anchorage on May 27, 1963. The trial judge announced that he had refreshed his memory from the record and from his notes and at the opening of the hearing made a statement for the record (R. Tr. 5). In that statement he reviewed his findings of various interferences by the defendant Kincaid & King with the work of the use plaintiff, engineering deficiencies, damages to use plaintiff's work and requirements for extra work (R. Tr. 6, 7) and stated (R. Tr. 7):

> "At the end of the 1955 work season, Olday had completed approximately two-thirds of his contract. The job was not finished during the work season primarily because of government change orders and faulty engineering."

The court went on to state that Olday was induced by Kincaid & King to withdraw the Miller Act suit,

then started, under Kincaid & King's promise to pay for labor used by Olday for the 1956 season and to pay for his gasoline charges (R. Tr. 7, 8). The court stated that after nine days of trial and 1,000 pages of testimony, the court came to the conclusion that Olday had performed extra work in the sum of $30,-000 and judgment in that sum should be entered in his favor, (R. Tr. 8).

The court stated that the dismissal of Continental Casualty Company was because the court was of the opinion that no judgment could be obtained against Olday on the counterclaim of Kincaid & King, and since there could be no liability against the principal there would be no liability against the surety (R. Tr. 9). Recital was then made that following the trial, counsel for Olday failed to prepare findings and judgment, and after a long delay the court requested counsel for Kincaid & King to prepare findings and judgment, which was done, and the findings so prepared were those that were signed (R. Tr. 9).

On the remand, counsel for all parties were heard fully. Testimony was not taken because, as the court stated (R. Tr. 143):

> "I don't see any necessity for reopening the case for the purpose of taking additional testimony. I think all of the testimony was available and although the record does show that at certain times I did sustain an objection relative to the introduction of testimony concerning the so-called counterclaims, nevertheless the record also indicates that a great deal of testimony was introduced relative to those counterclaims. And inasmuch as I distrusted the witnesses who were testifying and their records that they had made, I think it was perfectly within my rights refusing to hear any more testimony. I was

> satisfied and as far as I am concerned, the ruling of the court relative to exhibits U and W was proper, still is proper, shouldn't have been received. Now, and so I think that the thing to do is to have prepared or prepare supplemental findings of fact and conclusions of law."

Upon the basis of the testimony already taken, and based upon a review of the record, the court entered supplementary findings of fact and conclusions of law and judgment from which this appeal is taken.

II

SUMMARY OF ARGUMENT FOR APPELLEE.

This case was fully tried for nine days and defendants were permitted to put in all competent testimony offered on their counterclaim as well as upon the main case. The court's decision upon questions of fact was based upon the court's evaluation of voluminous, often conflicting testimony, and is supported by competent evidence. The judgment in favor of plaintiff Olday is the result of a complete evaluation of the claims and counterclaims of both parties resulting in a substantial balance due plaintiff and since there was no judgment to be entered against Olday, the principal, the court properly dismissed Continental Casualty Company, his surety.

III

ARGUMENT FOR APPELLEE

a. The Findings of Fact Are Amply Sustained

This case is in a peculiar posture before this court where the briefs in the previous proceeding as well as the record in that proceeding, No. 16519, are apparently before the court. We note that the assignments of error made by appellants are not the same in this proceeding as they were in the previous proceeding, yet the briefs in the previous proceeding are, by the terms of the order of the court in the last proceeding, apparently to be considered by the court here. In this rather confusing situation, we note that counsel for appellant indicate that their supplemental specifications of error, Nos. 4, 5, and 6, were argued in their opening and reply briefs which were previously on file.

In the same manner we call attention to the fact that appellee Continental Casualty Company in its previous brief has dealt with these subjects and with the question generally of the factual determinations of the court. As was pointed out in our previous brief, in reviewing factual determinations, this court does not upset findings of the trial court which are supported by competent evidence. See authorities cited in our previous brief.

The trial court at the hearing on remand explained at some length the evidence relied upon in arriving at the figures used in determining the damages. Starting on page 13 of the transcript on remand, the court points out what claims were allowed, the extent to which they were cut down, and the evidence upon which the court relied. It will be noted from

what the court says, that full consideration was given to Kincaid & King's claims of offset and counterclaim and the court relied upon the various exhibits which were admitted into evidence apparently without objection and upon testeimony and the court's evaluation of it and cut down some claims and allowed others. These are not figures drawn from the air, but are based upon the court's actual evaluation of the testimony. The court concludes:

> "And when I got through adding up everything according to 0-1, Olday was entitled to, and I got through adjusting the chargebacks that Kincaid & King had made against Olday, I came to the conclusion that there was approximately $30,000 between the two figures, and that's the way I arrived at the $30,000."

What counsel for appellant is apparently doing is asking the court to scan the record to determine whether it would have decided the facts differently than did the trial court. The trial court pointed out that Olday probably would have had a much larger claim had his records been in better condition. The trial court read into the record a portion of the record of the previous case that had been omitted from the previously certified transcript to this court (R. Tr. 34), where the court set out his remarks in the previous case as follows:

> "I feel sorry for him—I am talking about Olday now—because I feel if he would have kept adequate records he could have had somewhat of a substantial judgment, but I am going to have to—and the reporter has this IGM—but I think it's—decide this case primarily upon the records kept either by the company or by the defendant."

The court went on again at R. Tr. 34 to explain how the figures were arrived at.

With respect to appellant's attack upon the validity of the court's findings, we simply say that the court had to do the best it could with the type of records that were before it and it believed some witnesses, disbelieved others, relied upon some records, rejected others, and in a very complicated case, sifted out the conflicting testimony and arrived at figures respecting the amount of the damage. This is not the sort of factual matter to be reviewed on appeal. We again refer to our brief and authorities in the previous matter, No. 16519.

b. Appellant Was Fully Heard On Its Counterclaim

The main thrust of appellant's brief is directed to the contention that the court did not hear appellant's counterclaim. The record simply will not bear this out. Assignments of error 2, 3, 7, 8, 9, 11 and 12, are actually all concerned with this unfounded contention.

The fact is that the court took *extensive testimony relative to appellant's counterclaim.* Nowhere does counsel even contend that on the question of *liability* of appellees any restriction was placed upon the evidence offered by appellant.

Nowhere was plaintiff's counterclaim rejected, but plaintiff offered *extensive evidence* in proof not only of *liability* but also in proof of the amount of it, and this was received by the court. Plaintiff Olday rested the case on transcript 666, and thereafter defendant called the following witnesses: David L. Bear, Wayne Davis, Winfield W. Reynolds, Francis Poplosko, Herbert Kittler and Yewell A.

Smith. These witnesses all testified for defendant and nowhere in their testimony did there appear to have been any restrictions on the receipt of evidence except after the witness Smith had testified for approximately 52 pages of transcript, pages, 1036 to 1103, when two cumulative documents purporting to be compilations of items of the counterclaim were rejected by the court.

All of these witnesses went into the question of liability of Olday as well as Kincaid & King's own defense, and also into the question of the *items* of Kincaid & King's counterclaim. Counsel's complaint in appellant's brief is that plaintiff was not allowed to prove its back charges against Olday. References to the record will show that starting at about page 1053 of the transcript, witness Smith's testimony was concerned with little else than undertaking to prove the amount of these back charges. he testified at great length about what the back charges were, the sources of the figures and how much they were (Tr. 1054). Part of these are summarized in exhibit A-K. The court was fully advised of the basis of the claim against Olday and even of the amount of it (Tr. 1056). The court found that the claim against Olday for the back charges was not meritorious (R. Tr. 54).

Appellant's objection to the proceedings is actually all keyed to the court's rejection of exhibits U and W. These purported to be compilations of amounts to make up the $49,000 back charges of Kincaid & King against Olday. (Tr. 1055). The testimony showed that these documents actually represented compilations made long after the work was done and after suit had been started for the express purpose of developing a new source of

counterclaim, which had never previously been communicated to subcontractor Olday (Tr. 1102, 1103). These were made up from notes taken in 1955 and Olday was not notified that there were any back charges of $49,171 against him until after the suit started (R. Tr. 139) and financial statements had been given by Kincaid & King after 1955 and before trial of this action and no mention had been made of any such bank charges (R. Tr. 139) and the trial court simply did not trust these compilations as authentic back charges against the subcontractor and rejected these two exhibits.

Their rejection was really *not material* because they were only cumulative. Actually, the amounts claimed were stipulated (Tr. 1055), for whatever the figures were worth. Since the court did not find that the back charges were made in good faith or were justified, the admission of exhibits U and W would make no difference anyway because the items listed were not going to be allowed.

Kincaid & King had not proved its case for counterclaim because there was no proof of *liability*. Exhibits U and W only went to the question of the amount if liability had been established. As we said before, the court at no time limited Kincaid & King in their proof as to *liability* of Olday for the back charge. The court made it clear that it was determining there was no liability on this amount in a colloquy with counsel, page 1223 of the record, where the court said to counsel of Kincaid & King:

> "I think there is evidence before the court upon which the court can come to some conclusion whether there is or is not liability. The court may not be able to come to the conclusion as to the amount, but why have a big case here to

> determine the amount of liability until we determine first that there is a liability."

The court went on to say to Mr. Arnell, who was protesting about not admitting the documents (Tr. 1223):

> "You were presenting the evidence as to the amount of damage, not as to the liability—as to the amount of damage."

It was on the basis of the lack of proof of *liability* that the court declined to allow the plaintiff to introduce its two compilations, exhibits U and W. The court's ruling was correct since there was no liability established for the $49,000 item, and it would be a waste of the court's time to go into the proof as to the amounts that made it up.

Since there was a failure of proof to establish *liability* and the court has definitely determined that question in the main case, there was no occasion to reopen for the taking of evidence at the time of the hearing on the remand.

Exhibits U and W were at best only *cumulative* because the witnesses had already testified to amounts, and amounts, for what they were worth, had even been conceded, so that appellant was not in any way injured by the exclusion of these documents.

Apparently the exclusion of these documents was not considered a matter of any great moment by counsel for appellant at the time, as further efforts to prove these amounts were abandoned. Counsel for appellant said (Tr. 1104):

> "Mr. Arnell: If your honor please, in view of the court's last ruling, I think I better request to shorten the proceedings and abandon any

> further proof in support of the cross complaint except as to the amount of the two judgments, Hendricks and the Atkinson judgment, which I have set forth in our third party cross complaint. I wonder if counsel for Continental Casualty Company will stipulate that these amounts are correct."

Then counsel went on to say (Tr. 1104):

> "Mr. Arnell: Mr. Wilson asked that I clarify my statement, your honor. It relates to proof in support of the $49,000 counterclaim against Mr. Olday, insofar as our third party complaint, as we stand on that."

It will be noted that although the court declined to accept the compilations, exhibits U and W, appellant *made no offer of proof* of the *original records* from which they were compiled, and in fact made no offer of proof at all after they had been rejected. The trial court pointed out that if Kincaid & King had offered books of accounts, ledger sheets or other original records, they probably would have been accepted (R. Tr. 141). The court explained what it did as follows (R. Tr. 141):

> "The court: Well, counsel, I have had considerable experience relative to accounting and bookkeeping methods, and if Kincaid & King had kept a book of accounts in which it had a ledger sheet and in that ledger sheet had put in from time to time the amounts of the back charges, I probably would have accepted it. But you see, they didn't have any record at all. All they did, they, their books didn't show any record. All they did is when this complaint was filed, then they went back and reviewed their records to see whether or not they couldn't build up an offset against this claim, which they did, and I had a right to disregard and distrust that record. I am still of the opinion

> that I should have distrusted it and consequently it was in my prerogative not to consider it."

There was no occasion to reopen the taking of evidence at the remand where the appellants had not even preserved a proper record by making an *offer of proof,* but had abandoned all further efforts to prove amounts. They were not prejudiced by keeping out exhibits U and W, since those exhibits would merely go to substantiate an amount known to the court and concerning which *liability was not found.*

The court was fortified in his determination that there was no liability for these newly thought up back charges by the pleadings in the case. At the time of the trial the court was concerned with two judgments that had been rendered in Miller Act cases against the surety on the appellant's Miller Act bond. These are referred to as the Hendricks and the Atkinson cases. The amount of the first cross complaint filed by appellant was equal to the sum of these two judgments, $74,534.97 (R. Tr. 62, 63). The second amended complaint again used the same figure apparently indicating that what appellant was trying to offset by the counterclaim was the Atkinson and Hendricks judgments and there is no room left for the $49,000 figure which appellant sought at the trial to prove as a back charge against Olday.

We submit that the trial court was fully justified in finding that the back charge portion of the counterclaim was not valid and was not allowable. Insofar as the two judgments were concerned, they have been completely disposed of and paid (R. Tr. 18, 19). Those judgments having been discharged are no longer a factor in this case. In effect, *Mr.*

Olday has paid them. That is, his surety had advanced to him the money to pay one of the judgments and that has been satisfied, and the United States Fidelity & Guaranty Company, surety for Kincaid and King, has paid through Olday the other judgment. That is based upon the indebtedness of Kincaid & King to Olday as found by the court (R. Tr. 18, 19).

There was no prejudice to the appellant in the rejection of exhibits U and W because they only went to prove amounts of claims that were not allowed by the court and in any event it abandoned all efforts to make that proof, did not offer to submit the same information through *original records,* nor make any offer of proof during the trial, and there was no occasion to reopen the case for the taking of evidence at the time of the remand since the case had been thoroughly tried previously and on the issue of liability the decision had been against appellant.

Appellant's seventh assignment of error, that the court erred in making the supplemental finding of fact No. I, is simply baseless because the court had before it all of the testimony put in in nine days and a ruling on the merits of the counterclaim did not depend upon exhibits U and W which would have done no more than establish the detailed amounts of the claim which the court had determined was not meritorious and would be rejected. Likewise, assignment of error No. 8, directed to supplemental finding of fact, No. II, is not valid because the court had before it the full amount of the counterclaim and in fact this amount was even conceded for what it was worth by Olday's attorney. Assignment of error No. 9 is likewise unsubstantial because the

court did just what this court had indicated it should, that is, dispose of the counterclaim. The court by the supplemental findings of fact and supplemental judgment took definite action based upon the full trial of the case which had gone before, and now found as a fact that no sums are owing by plaintiff Olday to the defendant. The counterclaim has been disposed of and assignments of error 11 and 12 simply do not fit the action taken by the court.

c. The Court Properly Dismissed the Third Party Complaint

The court was clearly correct in dismissing with prejudice appellant's third party complaint. The third party complaint in this case was against Continental Casualty Company. In this case there is a judgment in favor of the principal Olday, and that judgment clearly relieves the surety of any liability. The most fundamental law of suretyship makes the liability of a surety depend upon the liability of the principal. Thus, in 50 Am. Jur, Suretyship, p. 987, § 126, the text states:

> "The natural limit of the obligation of the surety is to be found in the obligation of the principal, and when it is extinguished or released, the surety is in general liberated."

No action could be successfully prosecuted to judgment against the surety on the bond in this case without a judgment being given against the principal.

Counsel for appellant in their brief in the previous cause, No. 16519, cite *Glen Falls Indemnity Co. v. United States,* 229 F. (2d) 370, for the proposition that in a Miller Act case an action over might be

maintained against the surety on a subcontractor's bond. We would not quarrel with that decision but it simply has no application to the situation here. It is important to point out that in this case the bond of Continental Casualty Company *was not a statutory Miller Act bond* but was a conventional performance bond not dependent upon any statute to add to its terms. In this respect it was different from the bond of the prime contractor, Kincaid & King, which was a statutory Miller Act bond; and the action of use plaintiff against Kincaid & King and United States Fidelity & Guaranty Company was an action on a Miller Act bond. However, the counterclaim was not such an action, and whatever the rule may be in regard to maintaining an action against the surety under a Miller Act bond without having found liability against the principal, the rule is clear that in the kind of bond which Continental Casualty Company wrote for Olday, liability of the surety does not exist unless the principal is liable.

The surety, in such a case, is entitled to the benefit of all offsets in favor of the principal. In this case both the surety and the principal Olday were sued together and the prayer of the third party complaint was for a judgment against both. The text of 50 Am. Jur., Suretyship, p. 996, § 139, reads in part:

> "It is the general rule that when the surety and principal are joined as defendants, a claim due from the creditor to the principal may be advanced against the claim of the creditor."

Under this rule, even if it were to be established that the principal Olday had in some respects failed to meet the obligations of the contract but had an offset against Kincaid & King, there would be no

liability of the surety Continental Casualty Company, since the offset is available to exonerate the liability of the surety.

There is nothing in the bond of Continental Casualty Company that creates any primary liability on it. Its bond is strictly one of suretyship and since no obligation of Olday has been established, there is no obligation of Continental Casualty Company. It is impossible to separate the liability of the surety from that of the principal .

Appellant complained that the dismissal of Continental Casualty Company should not have been with prejudice. Such a dismissal, however, was the proper disposition of a cause tried on the merits. During the main trial, appellant's counsel undertook to take a voluntary dismissal without prejudice as to Continental Casualty Company. This was objected to by counsel for Continental Casualty Company (Tr. 1101). The court indicated that he did not see how there could be any liability of Continental Casualty Company if there was no liability of the surety (Tr. 1199, 1200), but then said that as to the right to dismiss without prejudice over the objection of counsel for the surety, that the court was uncertain as to the law, and stated (Tr. 1204):

> "Could we do this—I would be perfectly willing to do this—I would be willing to separate the question of the liability of the insurance companies and allow you to research the law and to present the matter to me on briefs, and then I will research the law for my own and follow your law and come to its conclusion as to whether or not there is any liability. I would be willing to do that. You could send me briefs down to Los Angeles and I can take my time and go over this case."

That was the posture in which the matter was left when the case adjourned. Thereafter, counsel for appellants *never submitted any briefs* to the judge at Los Angeles and when the plaintiff's council was dilatory in submitting proposed findings of fact, conclusions of law and judgment, the court called upon appellant's counsel to prepare finding of fact and conclusions of law in accordance with his interpretation and submit them to the court (R. Tr. 107). In the hearing on remand, the court points out that in preparing those findings of fact and conclusions of law, appellant's counsel, Mr. Arnell himself, proposed findings of dismissal of Continental Casualty Company with prejudice. The court said (R. Tr. 107):

> "And so, Mr. Arnell put in the findings and the judgment, the dismissal with prejudice, he did it on his own volition and not upon the direction of the court."

The court went on to say, on the same page:

> "So I assume, I assume, that it was Mr. Arnell who brought about the dismissal with prejudice of that proceeding."

Under the circumstances, we submit that the appellant is estopped even to raise the issue as to whether there was a right to dismiss Continental Casualty Company without prejudice.

However, under Rule 41 of the Rules of Pleading, Practice and Procedure, a voluntary dismissal could not occur under paragraph (a) (1) after an issue was joined without a stipulation, and it could not occur under subparagraph (2) without leave of the court. Subparagraph (2) reads in part:

> (2) By Order of Court. Except as provided in paragraph (1) of this subdivision of this

> rule, an action shall not be dismissed at the plaintiff's instance save upon order of the court and upon such terms and conditions as the court deems proper. If a counterclaim has been pleaded by a defendant prior to the service upon him of the plaintiff's motion to dismiss, the action shall not be dismissed against the defendant's objection unless the counterclaim can remain pending for independent adjudication by the court. Unless otherwise specified in the order, a dismissal under this paragraph is without prejudice."

The interpretations of the courts of the latter section are to the effect that it is *discretionary with the court* to allow or deny a a voluntary dismissal without prejudice. Moore's Federal Practice, Volume 5, page 1018, says of this rule:

> "The granting of the motion is within the court's discretion and not a matter of right."

The text cites in support of this statement a host of cases including *Larsen v. Switzer,* (8 CAA 1950) 183 F. (2d) 850; *United Railway Press Mfg. Co. v. Williams, White & Co.,* (7 CAA 1947) 168 F. (2d) 489. In *Shaffer v. Evans,* (10 CAA 1958) 263 F. (2d) 134, certiorari denied, 359 U. S. 990, 79 S. Ct. 1119, 3 L. Ed. (2d), it was held that there was no abuse of discretion in denial of motion for voluntary dismissal where the action was well along. The refusal to grant a voluntary dismissal to appellant with respect to a claim against Continental Cosualty Company was an exercise of the sound discretion of the court and it is not a matter of which appellant can complain where its own counsel invited the action by suggesting the form of the findings and judgment and by not submitting a brief to the court on his motion for voluntary dismissal as he had been invited to by the trial court.

The trial court here has decided complicated issues of fact upon a long and involved record after nine days of trial. There is nothing in the record to impeach the result arrived at as to factual determinations. The exclusion of cumulative evidence contained in the compilations, exhibits U and W, was in no way prejudical to defendant which had failed to establish any liability for the amounts which those two exhibits would have substantiated. The court has now disposed of the counterclaim and the appeal should be dismissed.

Respectfully submitted,

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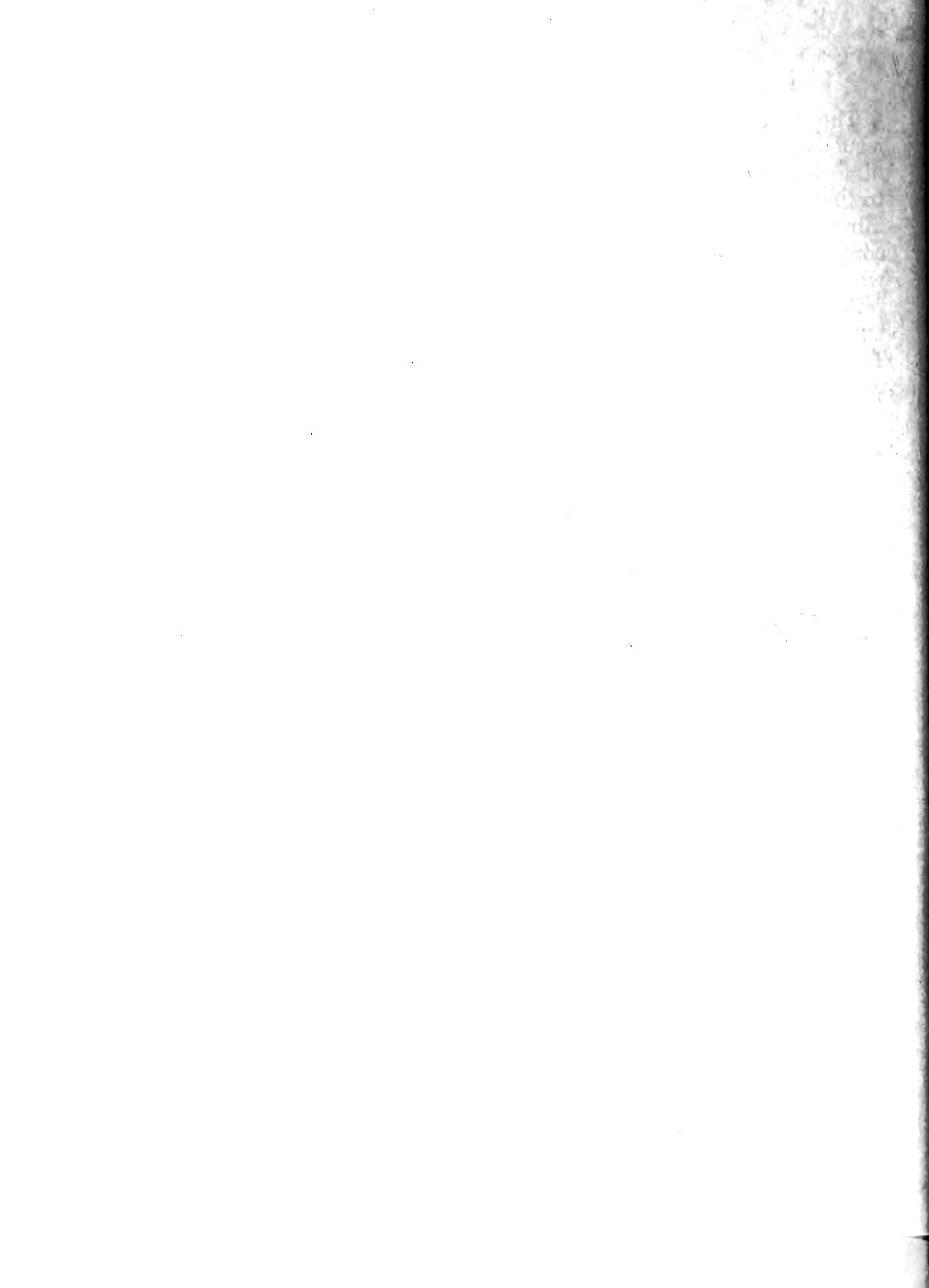
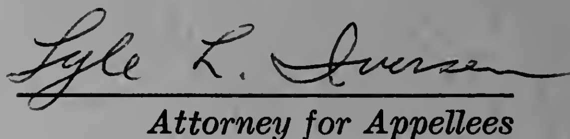


CERTIFICATION

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated this 26th day of November, 1963.



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